Supreme Court, U.S.
FILED
JAN 25 2010
OFFICE OF THE CLERK

No. 10-09-972

IN THE
Supreme Court of the United States

CLAUDE E. SALAZAR, DANA L. SALAZAR
Petitioners,

vs.

COMMISSIONER OF INTERNAL REVENUE
Respondent.

On Petition for a Writ of Certiorari to the United States Court of Appeals for the Second Circuit

PETITION FOR A WRIT OF CERTIORARI

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QUESTIONS PRESENTED

Does Section 7122 of the Internal Revenue Code permit the Internal Revenue Service to require taxpayers to increase an offer in compromise when the increased amount would exceed the amount the Service determined the taxpayers had the ability to pay?

May the Internal Revenue Service require a taxpayer to pay interest on funds held by a Chapter 7 bankruptcy trustee?

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PETITION FOR A WRIT OF CERTIORARI

Claude E. Salazar and Dana L. Salazar respectfully petition for a writ of certiorari to review the judgment of the United States Court of Appeals for the Second Circuit.

OPINIONS BELOW

The opinion of the court of appeals, dated July 23, 2009, can be found at 338 Fed. Appx. 75. Pet. App. 1a. An order denying rehearing and rehearing en banc, dated October 26, 2009, is unreported. Pet. App. 40a.

The tax court's opinions were reported at T.C. Memo 2008-38 and T.C. Memo 2006-7. Pet. App. 10a – 42a, 49a – 61a. The tax court's decisions and orders were unreported. Pet. App. 43a – 48a.

The Notices of Determination of the Internal Revenue Service were unreported. Pet. App. 62a – 78a, 79a – 88a.

JURISDICTION

Petitioner seeks review of a judgment of the court of appeals entered on July 23, 2009. 338 Fed. Appx. 75, Pet. App. 1a. Rehearing and rehearing en banc were denied on October 26, 2009. Pet. App. 89a – 90a. This Court has jurisdiction pursuant to 28 U.S.C. § 1254(1).

STATUTORY PROVISION INVOLVED

Section 7122 of Title 26, United States Code, provides:

> (a) Authorization. The Secretary may compromise any civil or criminal case arising under the internal revenue laws prior to reference to the Department of Justice for prosecution or defense; and the Attorney General or his delegate may compromise any such case after reference to the Department of Justice for prosecution or defense.
>
> (b) Record. Whenever a compromise is made by the Secretary in any case, there shall be placed on file in the office of the Secretary the opinion of the General Counsel for the Department of the Treasury or his delegate, with his reasons therefor, with a statement of--
>
> (1) The amount of tax assessed,
>
> (2) The amount of interest, additional amount, addition to the tax, or assessable penalty, imposed by law on the person against whom the tax is assessed, and

(3) The amount actually paid in accordance with the terms of the compromise.

Notwithstanding the foregoing provisions of this subsection, no such opinion shall be required with respect to the compromise of any civil case in which the unpaid amount of tax assessed (including any interest, additional amount, addition to the tax, or assessable penalty) is less than $ 50,000. However, such compromise shall be subject to continuing quality review by the Secretary.

(c) Rules for submission of offers-in-compromise.

(1) Partial payment required with submission.

(A) Lump-sum offers.

(i) In general. The submission of any lump-sum offer-in-compromise shall be accompanied by the payment of 20 percent of the amount of such offer.

(ii) Lump-sum offer-in-compromise. For purposes of this section, the term 'lump-sum offer-in-compromise' means any offer of

payments made in 5 or fewer installments.

(B) Periodic payment offers.

(i) In general. The submission of any periodic payment offer-in-compromise shall be accompanied by the payment of the amount of the first proposed installment.

(ii) Failure to make installment during pendency of offer. Any failure to make an installment (other than the first installment) due under such offer-in-compromise during the period such offer is being evaluated by the Secretary may be treated by the Secretary as a withdrawal of such offer-in-compromise.

(2) Rules of application.

(A) Use of payment. The application of any payment made under this subsection to the assessed tax or other amounts imposed under this title with respect to such tax may be specified by the taxpayer.

(B) Application of user fee. In the case of any assessed tax or other amounts imposed under this title with respect to such tax which is the subject of an offer-in-compromise to which this subsection applies, such tax or other amounts shall be reduced by any user fee imposed

under this title with respect to such offer-in-compromise.

(C) Waiver authority. The Secretary may issue regulations waiving any payment required under paragraph (1) in a manner consistent with the practices established in accordance with the requirements under subsection (d)(3).

(d) Standards for evaluation of offers.

(1) In general. The Secretary shall prescribe guidelines for officers and employees of the Internal Revenue Service to determine whether an offer-in-compromise is adequate and should be accepted to resolve a dispute.

(2) Allowances for basic living expenses.

(A) In general. In prescribing guidelines under paragraph (1), the Secretary shall develop and publish schedules of national and local allowances designed to provide that taxpayers entering into a compromise have an adequate means to provide for basic living expenses.

(B) Use of schedules. The guidelines shall provide that officers and employees of the Internal Revenue Service shall determine, on

the basis of the facts and circumstances of each taxpayer, whether the use of the schedules published under subparagraph (A) is appropriate and shall not use the schedules to the extent such use would result in the taxpayer not having adequate means to provide for basic living expenses.

(3) Special rules relating to treatment of offers. The guidelines under paragraph (1) shall provide that--

(A) an officer or employee of the Internal Revenue Service shall not reject an offer-in-compromise from a low-income taxpayer solely on the basis of the amount of the offer,

(B) in the case of an offer-in-compromise which relates only to issues of liability of the taxpayer--

(i) such offer shall not be rejected solely because the Secretary is unable to locate the taxpayer's return or return information for verification of such liability; and

(ii) the taxpayer shall not be required to provide a financial statement, and

(C) any offer-in-compromise which does not meet the requirements of subparagraph (A)(i)

or (B)(i), as the case may be, of subsection (c)(1) may be returned to the taxpayer as unprocessable.

(e) Administrative review. The Secretary shall establish procedures--

(1) for an independent administrative review of any rejection of a proposed offer-in-compromise or installment agreement made by a taxpayer under this section or section 6159 [26 USCS § 6159] before such rejection is communicated to the taxpayer; and

(2) which allow a taxpayer to appeal any rejection of such offer or agreement to the Internal Revenue Service Office of Appeals.

(f) Deemed acceptance of offer not rejected within certain period. Any offer-in-compromise submitted under this section shall be deemed to be accepted by the Secretary if such offer is not rejected by the Secretary before the date which is 24 months after the date of the submission of such offer. For purposes of the preceding sentence, any period during which any tax liability which is the subject of such offer-in-compromise is in dispute in any

judicial proceeding shall not be taken into account in determining the expiration of the 24-month period.

[(g)](f) Frivolous submissions, etc. notwithstanding any other provision of this section, if the Secretary determines that any portion of an application for an offer-in-compromise or installment agreement submitted under this section or section 6159 [26 USCS § 6159] meets the requirement of clause (i) or (ii) of section 6702(b)(2)(A) [26 USCS § 6702(b)(2)(A)], then the Secretary may treat such portion as if it were never submitted and such portion shall not be subject to any further administrative or judicial review.

STATEMENT OF THE CASE

A. Introduction

The Second Circuit upheld the tax court's decisions below, which, in turn, upheld determinations of the Internal Revenue Service ("Service"). *Salazar*, 338 Fed. Appx. 75 (2d Cir. 2009), Pet. App. 1a – 8a. The Second Circuit erred in two respects.

First, the Second Circuit held that the Service acted properly in rejecting the Salazars' offer in compromise under 26 U.S.C. § 7122. The original offer in compromise was presented in connection with a collection due process hearing held after the Salazars' Chapter 7 bankruptcy was discharged, but before distribution of bankruptcy estate assets. The Internal Revenue Service rejected the Salazars' offer because the Salazars did not agree to increase their offer by $20,000 above an amount the Service determined the Salazars had the ability to pay. In so ruling, the Second Circuit ignored the express language of Section 7122 that bars the Service from rejecting an offer in compromise "solely on the basis of the amount of the offer" and from insisting on more funds than necessary, resulting in "the taxpayer not having adequate means to provide for basic living

expenses." 26 U.S.C. § 7122(d)(3)(1)(A), 26 U.S.C. § 7122(d)(2)(A).

Second, the Court held that while post-petition penalties and interest were not collectible from the bankruptcy estate for liabilities paid by the estate, they were collectable from taxpayers, citing *Bruning v. United States*, 376 U.S. 358 (1964). This Court in *Bruning*, however, expressly addressed only interest on liabilities that were not paid out of the bankruptcy estate. *Bruning* does not support the imposition of penalties and interest on a taxpayer when money is held and payment is delayed by a bankruptcy trustee.

Here, taxpayers who had surrendered their assets to a bankruptcy estate trustee were unable to compromise tax liability unless they agreed to pay an amount equal to their calculated ability to pay plus the amount held by the bankruptcy trustee. *See* Notice of Determination of the Internal Revenue Service (Jan. 4, 2005), Pet. App. 70a ("taxpayer was advised that any offer amount deemed appropriate by the service based on their [sic] ability to pay, would have to be increased by $20,000 (the amount Appeals has determined would be received as a distribution)"). Taxpayers also were assessed penalties and interest against the funds held by the bankruptcy trustee under

the authority of *Bruning*, a case which decided an entirely different issue.

The Second Circuit did not acknowledge or even advert to these arguments, which were discussed in detail in the Salazars' briefing and in a timely petition for rehearing. The Second Circuit's decision conflicts with hornbook principles of statutory construction and administrative law. The decision also undermines important policy concerns with regard to Chapter 7 debtors.

B. Procedural History

Claude E. and Dana L. Salazar owed personal income taxes for tax years 1997, 1998 and 1999. 338 Fed. Appx. at 76, Pet. App. 2a. Claude E. Salazar owed employment taxes for periods from 1998 to 2001. *Id.*, Pet. App. At 2a – 3a. The Service sought collection by levy and Taxpayers timely requested a Collection Due Process Hearing. *See Id.* at 77, Pet. App. 3a. The Service upheld the levy because "accepting [an offer in compromise] could jeopardize the IRS's ability to collect an additional $20,000 from the Taxpayers' bankruptcy distribution, and not[ed] that Taxpayers had declined to increase their offer by that amount." *Id.*, Notice of Determination, Pet. App. 64a-65a, 70a.

The Salazars timely appealed the decision to the tax court. On January 18, 2006, the tax court dismissed that portion of the appeal related to Mr. Salazar's sole proprietorship liabilities on procedural grounds. *Salazar*, T.C. Memo 2006-7 (Tax Ct. 2006), Pet. App. 47a – 58a. After a second due process hearing, which was limited to Mr. Salazar's sole proprietorship liabilities, the Service again rejected the offer in compromise. Notice of Determination of the Internal Revenue Service (October 18, 2006), Pet. App. 76a – 86a. Mr. Salazar timely appealed the Service's determination. The two cases were consolidated and set down for trial. The tax court applied an abuse of discretion standard, found no abuse of discretion, and upheld the Service's decision. *Salazar*, T.C. Memo 2008-38 at *2, *28, Pet. App. 11a, 34a. Taxpayers timely appealed to the Second Circuit.

On appeal, the Salazars argued, *inter alia*, that the Manual provision relied upon by the Service, I.R.M. 5.8.10.2.3, impermissibly conflicted with 26 U.S.C. §§ 7122(d)(2) and (d)(3)(A), 26 C.F.R. § 301.7122-1(d)(3) and 26 C.F.R. § 301.7122-1(f)(3). The Salazars argued that it was improper to levy bank accounts and garnish wages of taxpayers in order to collect amounts that have been paid to the Service

through the bankruptcy process when, as a result, taxpayers would not be left with basic living expenses after collection.

The Salazars also argued that the Service has treated payments of tax liabilities from bankruptcy trustees as no payment at all when the payments are delayed. They argued that the Service may not assess and collect interest and penalties on funds that the taxpayer did not hold and which the taxpayers did not have use of.

In a summary order, the Second Circuit affirmed the rejection of the taxpayers' offer in compromise, holding that the Service had a "legitimate concern" and that there was nothing improper about the Service's referring to its administrative manual. *Salazar*, 338 Fed. Appx. at 78, Pet. App. 5a. The Second Circuit stated that it would only disturb rejection of an offer in compromise when the rejection "represents a clear abuse of discretion in the sense of clear abuse and unfairness by the IRS." *Id.*, Pet. App. 6a (citation omitted). The Second Circuit relied upon *Bruning*, "whatever its full scope may be," and determined that *Bruning* precluded any challenge by taxpayers to assessment against them of interest attributable to liabilities paid by the bankruptcy estate trustee. *Id.*, Pet. App. 7a. The Second Circuit denied a timely petition

for rehearing and rehearing *en banc*. Pet. App. 87a – 88a.

REASONS FOR GRANTING THE WRIT

I. THE SECOND CIRCUIT MISCONSTRUED SECTION 7122 OF THE INTERNAL REVENUE CODE.

The Second Circuit misconstrued the applicable statute and ignored limitations that Congress imposed on the Service's discretion to reject an offer in compromise. The Second Circuit relied on the discretionary language of Section 7122(a), while ignoring the important limitations imposed under Section 7122(d).

Congress expressly prescribed the limits of the Service's discretion through the IRS Restructuring and Reform Act by amending 26 U.S.C. § 7122 and adding what is now subsection (d)(3)(A) (discussed below). Section 7122 (d)(3)(A) limits the Internal Revenue Service's discretion, and the Service has enacted regulations consistent with that restricted discretion. *See* 26 C.F.R. § 301.7122-1(f)(3). The statute simply does not grant the Service broad discretion.

Section 7122(d)(3)(A) limits the Service's discretion to deny an offer in compromise. Congress added the relevant language as part of the IRS Restructuring

and Reform Act of 1998, which added then subsection (c)(3)(a) (now (d)(3)(A)) to 26 U.S.C. § 7122. *See* H. Conf. Rep. No. 105-599, at 266 [1998].[1]

As amended, Section 7122 expressly precludes the Service from denying an offer in compromise "solely on the basis of the amount of the offer." 26 U.S.C. § 7122 (d)(3)(A). The statute also requires the Service, in assessing an offer in compromise, to ensure that the taxpayers have "an adequate means to provide for basic living expenses." 26 U.S.C. § 7122(d)(2)(A). Furthermore, the statute provides that the Service "shall not" revise an OIC if it will "result in the taxpayer not having adequate means to provide for basic living expenses." 26 U.S.C. § 7122(d)(2)(B). The Service's own regulations recognize these express statutory commands. *See, e.g.*, 26 C.F.R. § 301.7122-1(c)(2) (the Service "will permit taxpayers to retain sufficient funds to pay basic living expenses"), 26 C.F.R. § 301.7122-1(f)(3) (the

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[1] Even prior to the amendment, the Service recognized, in 1992, a shift in Service policy for evaluation of offers in compromise from "maximum collection with the least possible costs to the government" to "collection of what is potentially collectible at the earliest possible time and at the least cost to the government." 102 PLI/NY 211 *comparing* I.R.M. 57(1)104 (August 24, 1989) *to* I.R.M. 57(10) (February 26, 1992).

Service may not reject an OIC "solely on the basis of the amount of the offer").

There is no basis for concluding that the Service can ignore the limitations set by Section 7122 by insisting that a taxpayer supplement an offer in compromise by paying the Service the equivalent of funds that the Service can collect from a bankruptcy trustee. Congress could have used, but chose not to use, language that required that the "amount of the offer" from a taxpayer include amounts being held by bankruptcy trustees. Similarly, the statutory requirement that taxpayers be allowed to retain "basic living expenses" contains no language limiting the allowance for basic living expenses to taxpayers who have not paid assets over to a bankruptcy trustee under Chapter 7 of the Bankruptcy Act.

In this case, the Service's putative ground for rejecting the offer in compromise was its feared inability to collect bankruptcy estate proceeds. On this issue, the Second Circuit implicitly adopted the Tax Court's reasoning: "As the Tax Court observed, the record reveals that the Appeals Office had a legitimate concern about forfeiting the IRS's right to Taxpayers' bankruptcy distribution." *Salazar*, 338 Fed. Appx. at 78, Pet. App. 5a. That "legitimate concern," however, was the Service's concern that the bankruptcy

proceeds "would go to other creditors or to the taxpayer." *Salazar*, T.C. Memo 2008-38 at *23, Pet. App. 29a. The Tax Court acknowledged that the taxpayers here had effectively eliminated any risk that the distribution would be made to the taxpayers by "offer[ing] to relinquish any claim to the bankruptcy distribution for the benefit of respondent." *Id.* at *22, Pet. App. 29a. Therefore, the only remaining "legitimate concern" was that the bankruptcy distribution might go to other creditors. On this issue, the Tax Court held that the taxpayers "fail[ed] to present any authority that their other creditors would be precluded from objecting to any distribution to respondent after the acceptance of their offer-in-compromise." *Id.* at *23, Pet. App. 29a.

Rather than requiring the Service to prove compliance with Section 7122, the Tax Court placed the burden of proof on the taxpayers. On the one hand, the Tax Court faulted taxpayers for "fail[ing] to point to any authority to suggest that respondent's position that accepting an offer-in-compromise jeopardized the bankruptcy distribution was without legal basis," *id.* at *22, Pet. App. 29a,while, on the other hand, finding only that the Service's "administrative record suggests" that "respondent's risk, or at least [its] perceived

risk, goes beyond simply the release of any secured claim [it] has to the bankruptcy distribution." *Id.* at *21-22, Pet. App. 28a – 29a. The Tax Court, in effect, shifted the burden to taxpayers to prove that bankruptcy estate proceeds are collectible.

A mere theoretical risk that, for example, another creditor would somehow trump the Service's claim is presumably present in every Chapter 7 case. To permit the Service to rely on such a theoretical risk to reject an offer in compromise that it would otherwise not reject under Section 7122(d) is to eviscerate those restrictions on the Service's discretion to reject an offer in compromise. Even if the bankruptcy estate proceeds were ever so at risk, the Service has no authority to require that taxpayers add to an offer in compromise an amount equal to the expected bankruptcy estate distribution, where the resulting amount would exceed the funds necessary for basic living expenses. While the Second Circuit was correct in holding that the Service has discretion to accept or reject an offer in compromise, it ignored the relevant limitations on that discretion set forth in Section 7122. The statute expressly forbids what the Service did here, which was to deny an offer in compromise based on the amount offered and to require an offer amount beyond that

which would leave enough for basic living expenses.

In short, the Second Circuit disregarded both the plain language of the statute and related regulations. In doing so, the Second Circuit affirmed the Service's imposition of restrictions for post-Chapter 7 taxpayers that Congress never authorized.

II. THE SECOND CIRCUIT DECISION AFFIRMING THE IMPOSITION OF INTEREST CONFLICTS WITH THIS COURT'S PRECEDENT.

The decision conflicts with Second Circuit precedent and is founded on Supreme Court precedent which is inapplicable to the issues presented. Sup. Ct. R. 10(c). Further, the decision has the effect of eliminating, or at least discouraging,—without relevant analysis—the use of the Chapter 7 bankruptcy process as an important, permissible tool in rehabilitation of debtors.

The Second Circuit held that Taxpayers were precluded from arguing that interest was improperly accrued against liabilities paid through the bankruptcy trustee, citing two cases: *Bruning* and *In re. Johnson Elec. Corp.*, 442 F.2d 281 (2d Cir. 1971). *See Salazar*, 338 Fed. Appx. at 78, Pet. App. 7a (citing *Bruning*, 376 U.S. at 360 and *Johnson Elec.*, 442 F.2d at 284).

However, The issue presented in this case is controlled by *City of New York v. Saper, Trustee in Bankruptcy*, 336 U.S. 328 (1949). The cases cited by the Second Circuit did not address the issue at hand, leaving *Saper* as the controlling precedent.

The issue in *Saper* was whether the City of New York, a creditor, was entitled to interest on its distribution from the bankruptcy trustee only until the date the bankruptcy petition was filed or through the date of payment by the estate. *Id.* at 329. This Court held that the City was only entitled to interest until the date of the filing of the bankruptcy petition, and not until the date of payment by the bankruptcy estate trustee. *Id.* at 341. The rule stopping interest as of the date a bankruptcy petition is filed is "a fundamental principle of the English bankruptcy system which we copied." *Id.* at 330 (citation omitted). In *Saper*, this Court held that "[t]he longstanding rule against post-bankruptcy interest . . . appears implicit" in the relevant statutes, and the Court declined to read into the bankruptcy statutes an allowance for interest on non-discharged tax debts paid by the trustee. *Id.* at 332. Although the issue was not before the Court, nothing in the decision suggested that the creditor could recoup such post-petition interest from the debtor.

In *Bruning*, this Court held that the Service may assess and collect post-petition interest from liabilities owed by the taxpayer, namely, *non-discharged liabilities that have not been paid by the bankruptcy estate*.[2] In doing so, the Court did not decide whether the Service could properly assess and collect interest on the non-discharged liabilities paid out of the estate by the bankruptcy trustee. *Bruning*, 376 U.S. at 362 ("the instant case concerns the debtor's personal liability for post-petition interest on a debt that survives bankruptcy to the extent it is not paid out of the estate"). The *Bruning* decision, therefore, did not and could not overrule existing precedent, which remains controlling.

Johnson Electric also did not decide the issue at hand. In that case, interest was assessed against funds that the debtor had use of, which is not the case here. *Johnson Electric* was a Chapter 11 reorganization case where the bankruptcy distribution at

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[2] *See Bruning*, 376 U.S. at 362, 363 (the issue presented was "interest on a debt for taxes which survives bankruptcy to the extent it is not paid out of the estate" and holding that "interest on an unpaid tax debt not discharged" remains a liability of the debtor); *id.* at 360 (petitioner was liable for interest on tax debt "not satisfied out of the bankruptcy estate"); *id.* at 361 (Congress did not limit accrual of interest "on an undischarged and unpaid liability").

issue, in compliance with Chapter 11 procedures, was "being used by the debtor in possession" and, thus, there was "no real hardship in the bankrupt's having to pay interest." *Johnson Elec.*, 442 F.2d at 284. This holding is consistent with *Bruning*, which held that "interest is considered to be the cost of the use of the amounts owing a creditor and an incentive to prompt repayment and, thus, an integral part of a continuing debt." 376 U.S. at 360. Here, Taxpayers were in Chapter 7 bankruptcy, not Chapter 11 bankruptcy, and, unlike a Chapter 11 debtor, they did not have use of the funds.

Without addressing this distinction, the Second Circuit simply held in summary fashion that *Bruning*, "whatever its full scope may be, precludes these Taxpayers from arguing that post-petition interest could not accrue on non-dischargeable tax liability." *Salazar*, 338 Fed. Appx. at 78, Pet. App. 7a (citing *Bruning* 376 U.S. at 360).[3]

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[3] Initially, the Service assessed penalties during the pendency of the bankruptcy proceeding. Taxpayers objected to the Service's assessment of failure to pay penalties under 26 U.S.C. § 6658, and the parties have resolved that issue. *See Salazar*, 338 Fed. Appx. at 77, n. 3, Pet. App. 4a. However, Taxpayers also objected to the assessment of failure to pay penalties assessed against liabilities that were ultimately paid in full by the bankruptcy estate distribution. The

The Second Circuit's further holding that interest was proper because "Taxpayers would have remained liable" for interest if the Service "had not filed a proof of claim in their bankruptcy proceeding," *id.*, does no more than state that Taxpayers would owe interest on liabilities not paid through the bankruptcy estate. This is precisely *Bruning*'s holding, but it does not address the issue of interest on liabilities paid through the estate.

III. THE ISSUES PRESENTED ARE IMPORTANT QUESTIONS OF FEDERAL LAW.

The Court should consider the issues presented in this case because of the highly significant consequences of the Second Circuit's decision. Sup. Ct. R. 10(c). Both the portion of the decision concerning the rejection of the offer in compromise and the portion concerning the imposition of interest have significant potential detriment to Chapter 7 debtors. The Second Circuit decision summarily alters the level of protection afforded to taxpayers who pay tax liabilities through the bankruptcy process—

Second Circuit failed to address or decide whether failure to pay penalties were properly assessed by the Service against liabilities paid through the bankruptcy estate distribution.

one that has traditionally been used as a tool for rehabilitation of taxpayers and, ultimately, assists taxpayers in resuming timely and full tax payments in the future. Indeed, these protections are recognized by the Service. *See, e.g.*, I.R.M 5.9.4.9(1).

The Second Circuit's sweeping ruling that the Service may collect by levy upon taxpayers those liabilities previously paid by taxpayers through a bankruptcy trustee, leaves little question that the opinion, if left undisturbed, will cause the Service to collect by levy in amounts that will not leave taxpayers enough funds for basic living expenses. Further, taxpayers who pay tax liabilities through the bankruptcy process will be treated differently from other taxpayers, because the standards set forth by Congress, which ensure that taxpayer debtors retain basic living expenses, will be nullified by this decision.

CONCLUSION

For the reasons set forth above, the petition should be granted.

Respectfully submitted,

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January 2010

CLAUDE E. SALAZAR, DANA L. SALAZAR, Petitioner-Appellants, v. COMMISSIONER OF INTERNAL REVENUE, Respondent-Appellee.

No. 08-2670-ag(L), No. 08-3842-ag(CON)

UNITED STATES COURT OF APPEALS FOR THE SECOND CIRCUIT

338 Fed. Appx. 75; 2009 U.S. App. LEXIS 16268; 2009-2 U.S. Tax Cas. (CCH) P50,518; 104 A.F.T.R.2d (RIA) 5471

July 23, 2009, Decided

NOTICE: PLEASE REFER TO FEDERAL RULES OF APPELLATE PROCEDURE RULE 32.1 GOVERNING THE CITATION TO UNPUBLISHED OPINIONS.

PRIOR HISTORY: *Salazar v. Comm'r, T.C. Memo 2008-38, 2008 Tax Ct. Memo LEXIS 38 (T.C., 2008)*

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JUDGES: Present: GUIDO CALABRESI, ROBERT A. KATZMANN, Circuit Judges, RICHARD K. EATON, Judge.[1]

OPINION

[*76] SUMMARY ORDER

UPON DUE CONSIDERATION of the appeals from the United States Tax Court (Goeke, J.), it is hereby **ORDERED, ADJUDGED** and **DECREED** that the decisions of the Tax Court are AFFIRMED.

Appellants Claude E. Salazar and Dana L. Salazar (collectively, "Taxpayers") appeal *pro se* from the Tax Court's decisions entered on February 25, 2008 and June 2, 2008, sustaining the collection by levy of unpaid employment taxes for the calendar quarters ending December 31, 1998, through June 30, 2001, and unpaid personal income taxes for the years 1997, 1998, and 1999. We assume the parties' familiarity with the underlying facts, the procedural history, and the issues on appeal.

Taxpayers jointly operated an art gallery in Nevada that was organized in Mr. Salazar's name [**2] as a sole proprietorship. Certain of the gallery's employment taxes were not paid from 1998 to 2001, and the Taxpayers failed to pay their

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[1] The Honorable Richard K. Eaton of the United States Court of International Trade, sitting by designation.

personal income taxes for the years 1997, 1998, and 1999. In January 2001, Taxpayers filed for Chapter 13 protection, which was later converted to a Chapter 7 proceeding. The Internal Revenue Service ("IRS") filed a proof of claim, later amended, in the bankruptcy [*77] proceeding covering these tax liabilities, to which Taxpayers did not object. Taxpayers received a discharge in July 2002, however, their tax liabilities were non-dischargeable. *See 11 U.S.C. § 523(a)(1)(A).* In August 2005, the bankruptcy trustee disbursed some funds to the IRS, which it applied solely to the employment tax liability.

On October 27, 2003, during the course of the bankruptcy proceeding, the IRS issued a notice of intent to levy for Taxpayers' unpaid income taxes. This notice informed Taxpayers that they had the right to a collection due process ("CDP") hearing with the IRS Appeals Office. Taxpayers asked for a hearing, during which they submitted an offer-in-compromise ("OIC") to the Appeals Office seeking to resolve all outstanding income tax liabilities. Thereafter, having [**3] reviewed the IRS Internal Revenue Manual ("IRM"), the Appeals Office rejected Taxpayers' OIC, explaining that accepting it could jeopardize the IRS's ability to collect an additional $ 20,000 from the Taxpayers' bankruptcy distribution, and noting that Taxpayers had declined to increase their offer by that amount.

On February 22, 2006, the IRS issued an additional notice of intent to levy Mr. Salazar's assets to satisfy the employment tax liability. He

likewise asked for a CDP hearing, during which he indicated that he wished the Appeals Office to reconsider its decision not to accept the first OIC. He further objected to the accrual of post-petition interest and to the IRS's decision to apply Taxpayers' joint bankruptcy distribution solely to the employment tax liability. Mr. Salazar then submitted a second OIC in an effort to settle all of Taxpayers' liabilities. After a hearing, the Appeals Office rejected the second OIC, finding that the IRS's reasonable collection potential far exceeded the amount offered. The Appeals Office then issued a notice of determination sustaining the levy.

Taxpayers filed separate petitions in the Tax Court, [2] which were consolidated. The Tax Court then [**4] issued a single Memorandum Findings of Fact and Opinion, although it later entered separate decisions on each petition. In doing so, the Tax Court sustained both levies.

Three primary arguments[3] are raised on appeal: (1) that the Appeals Office erred in rejecting Taxpayers' first OIC; (2) that post-petition interest should not have accrued on tax liabilities that were paid by the distribution of funds from the bankruptcy; and (3) that the Tax Court erred in

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[2] Taxpayers originally filed a single joint petition in the Tax Court challenging the Appeals Office's rejection of their first OIC. However, because the employment tax liability was not part of the initial levy, that portion of the petition was dismissed for lack of jurisdiction.

[3] An additional argument, concerning the IRS's ability to assess statutory penalties during the pendency of Taxpayers' bankruptcy case, has been resolved by the parties.

permitting the IRS to apply the August 2005 bankruptcy distribution solely to the employment tax liability.

We review the Tax Court's decisions *de novo*, and therefore we stand in the shoes of the Tax Court and review the Appeals Office's determinations for abuse of discretion where the underlying [**5] liability is not at issue and de novo when it is. *See Robinette v. Comin'r, 439 F.3d 455, 462 (8th Cir. 2006); see also Living Care Alternatives of Utica, Inc. v. United States, 411 F, 3d 621, 625, 628-31 (6th Cir. 2005).*

Taxpayers insist that the Appeals Office's rejection of their OIC, (1) based on Taxpayers' refusal to increase their offer to account for the IRS's possible recovery [*78] in bankruptcy; and (2) based on the IRS's reliance on the IRM, was unlawful. These contentions are without merit. As the Tax Court observed, the record reveals that the Appeals Office had a legitimate concern about forfeiting the IRS's right to Taxpayers' bankruptcy distribution and there was nothing improper about it consulting the IRM. *See Salazar v. Comm r, T.C. Memo 2008-38, 2008 WL 495313, at *9* ("[The Appeal's Office] was simply applying respondent's guidelines on evaluating offers-in-compromise, including the reasonable collection potential, to the specifics of petitioners' offer."). Further, Taxpayers have made no serious argument as to why the Appeals Office should not consult the IRM. *See Christopher Cross, Inc. v. United States, 461 F.3d 610, 613 (5th Cir. 2006)* ("Taxpayer has offered no

viable [**6] support for its contention that the Officer cannot utilize the guidelines set forth in the Manual when making the discretionary decision to return a submitted offer in compromise."). Thus, because the Appeals Office acted within its discretion and, in fact, consistent with the relevant Treasury regulation, the Tax Court's decision must be affirmed. *See 26 C.F.R. § 301.7122-1(c)(1)* ("[T]he decision to accept or reject an offer to compromise ... is left to the discretion of the Secretary."); *see also 26 U.S.C. § 7122(a)* ("The Secretary may compromise any civil or criminal case arising under the internal revenue laws ... .") (emphasis added)); *Murphy v. Comm'r, 469 F.3d 27, 32 (1st Cir. 2006)* ("We will only disturb the rejection of [an] offer-in-compromise if it represents a clear abuse of discretion in the sense of clear taxpayer abuse and unfairness by the IRS.") (internal quotation marks omitted)).

Taxpayers next argue for abatement of interest on their tax liabilities because of an alleged delay in distribution of funds by the bankruptcy trustee. As to this claim, the Tax Court noted that the IRS "was no more in control over the distribution of the bankruptcy proceeds than were [**7] [Taxpayers]" and held that the IRS was not prohibited from seeking interest for the time period that Taxpayers' bankruptcy proceeding was pending. *See Salazar, T. C. Memo 2008-38, 2008 WL 495313, at * 12* (citations omitted). In reaching its conclusion, the Tax Court relied in part upon *Woodward v. United States, 113 B.R. 680, 684 (Bankr. D. Or. 1990)*, in which the court explained

that most courts that have considered the issue of whether a debtor remains liable for post-petition interest have found the Supreme Court's decision in *Bruning v. United States, 376 U.S. 358, 84 S. Ct. 906, 11 L. Ed. 2d 772, 1964-2 C.B. 500 (1964)*, controlling.

We, too, believe that *Bruning v. United States*, whatever its full scope may be, precludes these Taxpayers from arguing that post-petition interest could not accrue on non-dischargeable tax liability. *See 376 U.S. at 360* (explaining that "logic and reason indicate that post-petition interest on a tax claim excepted from discharge ... should be recoverable in a later action against the debtor personally"); *see also In re Johnson Elec. Corp., 442 F.2d 281, 284 (2d Cir. 1971)*. Moreover, Taxpayers would have remained liable on their non-dischargeable liability--including interest--even had the IRS not [**8] filed a proof of claim in their bankruptcy proceeding. *See 11 U.S.C. § 523(a)(1)(A)*. Therefore, we find Taxpayers' claim that the IRS is not entitled to collect post-petition interest to be without merit.

Finally, Taxpayers argue that the Tax Court erred in permitting the IRS to apply Taxpayers' bankruptcy distribution to the employment tax liability. Here, we review the Tax Court's conclusion of law *de novo*. *See Sunik v. Comm'r, 321 F.3d 333, 337 (2d Cir. 2003); 26 U.S.C. § 7482('c)(1)*. [*79] Taxpayers claim that the application of the distribution to what they insist is Mr. Salazar's liability alone is unfair.

Notwithstanding Taxpayers' fairness concerns, this claim must fail. The payments from Taxpayers' bankruptcy estate were involuntary, and, therefore, Taxpayers had no entitlement to designate where those payments were to be applied. *See United States v. Pepperinan, 976 F.2d 123, 127 (3d Cir. 1992)* ("Under ... long-standing IRS policy, taxpayers may designate the application of tax payments that are voluntarily made, but may not designate the application of involuntary payments."); *In re Kaplan, 104 F.3d 389, 596 n.16 (3d Cir. 1997)* ("[A] tax payment has been considered 'involuntary' [**9] when it is made to agents of the United States as a result of... levy or from a legal proceeding in which the Government is seeking to collect its delinquent taxes or file a claim therefor.") (internal quotation marks omitted)). Accordingly, the IRS was free to allocate the funds to Taxpayers' tax liabilities as it saw fit, and it cannot be said to have acted improperly given that the Taxpayers operated the art gallery jointly. *See Davis v. United States, 961 F.2d 867, 879 (9th Cir. 1992)* ("Involuntary payments, like undesignated [voluntary] payments, may be credited as the IRS desires."); see also Rev. Proc. 2002-26, 2002-1 C.B. 746, at § 3.02 (stating that IRS will apply non-designated payments in a manner that will "serve its best interest").

We have considered Taxpayers' remaining arguments and find them to be without merit. Accordingly, the decisions of the Tax Court are hereby **AFFIRMED**.

CLAUDE E. AND DANA L. SALAZAR, Petitioners v. COMMISSIONER OF INTERNAL REVENUE, Respondent CLAUDE E. SALAZAR, Petitioner v. COMMISSIONER OF INTERNAL REVENUE, Respondent

Nos. 2203-05L, 23547-06L

UNITED STATES TAX COURT

T. C. Memo 2008-38; 2008 Tax Ct. Memo LEXIS 38; 95 T.C.M. (CCH) 1149

February 25, 2008, Filed

SUBSEQUENT HISTORY: *Affirmed by Salazar v. Comm'r, 2009 U.S. App. LEXIS 16268 (2d Cir., Jul), 23, 2009)*

PRIOR HISTORY: *Salazar v. Comm'r, T. C. Memo 2006-7, 2006 Tax Ct. Memo LEXIS 8 (T. C, 2006)*

COUNSEL: [* 1] Jeremy H. Speich and Dana L. Salazar, for petitioners.

Diana P. Hinton, for respondent.

JUDGES: Goeke, Joseph Robert

OPINION BY: JOSEPH ROBERT GOEKE

OPINION

MEMORANDUM FINDINGS OF FACT AND OPINION

GOEKE, *Judge*: These consolidated cases arise from petitions for judicial review of two notices of determination concerning collection action(s) under *section 6320* and/or *6330*.[1] In response to a notice of intent to levy issued by respondent with respect to outstanding income tax liabilities, petitioners Claude and Dana Salazar (Mr. and Mrs. Salazar) submitted an offer-in-compromise for all of their outstanding tax liabilities, which also included employment tax liabilities of Mr. Salazar. Petitioners also sought abatement of penalties for the period their bankruptcy petition was pending. After Mr. Salazar individually received a notice of intent to levy with respect to his employment tax liabilities, Mr. Salazar submitted a second offer-in-compromise and again challenged the assessment of penalties and interest during the pendency of petitioners' bankruptcy petition. Respondent issued separate notices of determination rejecting both offers-in-compromise and sustaining the proposed collection actions. [*2]

We have jurisdiction to review respondent's collection determination relating to the

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[1] Unless otherwise indicated, all section references are to the Internal Revenue Code, as amended, and all Rule references are to the Tax Court Rules of Practice and Procedure.

employment tax liabilities as well as the income tax liabilities under amended *section 6330(d)(1)* because respondent made his determination more than 60 days after August 17, 2006. *See Callahan v. Commissioner, 130 T. C. 3, 2008 U.S. Tax Ct. LEXIS 3 (2008).* Respondent has now admitted to assessing a penalty erroneously for petitioners' 1997 income tax year while their bankruptcy petition was pending and has agreed to correct this error. Because we find respondent did not abuse his discretion in rejecting petitioners' offers-in-compromise, and because we find that respondent did not otherwise erroneously assess penalties and interest, we sustain respondent's determinations.

FINDINGS OF FACT

Some of the facts have been stipulated and are so found. The stipulations of facts and related exhibits are incorporated herein by this reference. At the time the petitions were filed, petitioners, husband and wife, resided in New York.

Previously, petitioners were residents of Nevada, where they owned [*3] and operated a retail art gallery named Artistic Nature. While operated by both petitioners, the gallery was organized as a sole proprietorship in the name of Mr. Salazar. The operation, and ultimately the failure, of Artistic Nature has led to the current proceedings. Respondent seeks collection of petitioners' outstanding Federal income taxes, penalties, and interest for taxable years 1997, 1998, and 1999. Respondent also seeks to collect the

outstanding employment tax liabilities of Mr. Salazar related to Artistic Nature from 1998 through 2001.

On January 23, 2001, when Artistic Nature was failing, petitioners filed for chapter 13 bankruptcy protection in the U.S. Bankruptcy Court for the District of Nevada. Petitioners captioned their bankruptcy petition as "Claude E. Salazar dba Artistic Nature and Dana Salazar dba Artistic Nature." The petition was later converted to a chapter 7 proceeding.

On February 1, 2001, respondent filed a proof of claim with the bankruptcy court, which respondent later amended. On respondent's last amendment to the proof of claim, filed on September 27, 2003, respondent listed a secured claim of $19,915.40, an unsecured priority claim of $43,673.45, and [*4] an unsecured general claim of $8,850.74. The secured claim related to a lien respondent had previously filed with respect to petitioners' 1997 and 1998 income tax liabilities, and it included penalties and interest. The unsecured priority claim also included interest. Petitioners, while represented by counsel, did not file an objection to respondent's claims. On July 25, 2002, petitioners received a discharge of debtor from all dischargeable debts. On August 22, 2005, the bankruptcy trustee disbursed $17,834.51 to respondent. The bankruptcy case was closed on March 30, 2006.

During the 2000, 2001, and 2002 tax years, petitioners allowed withholdings from income to exceed their income tax liabilities, which created overpayments totaling $15,814.91. On October 2, 2003, respondent applied these overpayments to petitioners' 1997 income tax liabilities. On October 6, 2003, respondent assessed $3,192.34 in interest and an additional $1,216.52 failure to file penalty for petitioners' taxable period ending December 31, 1997.

After petitioners received the discharge of debtor, respondent initiated collection on petitioners' liabilities. On October 27, 2003, respondent sent petitioners a [*5] separate letter for each of the outstanding liabilities stating that he intended to seek collection by levy. Respondent's notification of intent to levy indicated the following liabilities, including penalties and interest:

Tax From Form	Period Ending	Unpaid Balance
1040	12/31/1997	$ 437.21
1040	12/31/1998	5,923.33
1040	12/31/1999	6,923.71
941	12/31/1998	3,970.30
941	3/31/1998	6,248.92

941	6/30/1999	5,658.56
941	9/30/1999	7,000.45
941	12/31/1999	6,122.27
941	3/31/2000	5,006.08
941	6/30/2000	5,626.37
941	9/30/2000	6,575.15
941	12/31/2000	5,855.57
941	3/31/2001	5,118.99
941	6/30/2001	2,210.01

On or about December 6, 2003, respondent issued a final notice of intent to levy related to the income tax liabilities for 1997, 1998, and 1999. Respondent's notice of intent to levy did not include Mr. Salazar's employment tax liabilities. On December 16, 2003, petitioners submitted a Form 12153, Request for a Collection Due Process Hearing. Notwithstanding the fact the final notice of intent to levy pertained only to petitioners' income tax liabilities, petitioners indicated they were seeking collection review with respect to both their income and employment tax liabilities. Petitioners stated: "We declared Chapter 7 bankruptcy in January [*6] 2001. Discharge was July 2001 [sic] -- there were assets -- the

bankruptcy is still open pending filing of final accounting report by the trustee. Calls to IRS and IRS bankruptcy Department have gone unanswered." Despite the request for a collection review hearing, respondent issued the levy. Upon realizing that he should have suspended the proposed levy action until after the hearing and any appeals, respondent released the levy. *See sec. 6330(e)(1); Grover v. Commissioner, T.C. Memo. 2007-176.*

Petitioners' file was forwarded to Appeals Settlement Officer Bruce Conte. On May 14, 2004, Mr. Conte contacted petitioners to schedule a conference. At the same time, Mr. Conte contacted respondent's internal bankruptcy specialists. Mr. Conte received a fax from a specialist outlining petitioners' bankruptcy file and noting that "secured claims get paid first and then priority." Mr. Conte noted in his case record that there were also outstanding employment tax liabilities for petitioners and that final collection notices had not yet been issued with respect to those liabilities.

On or about May 24, 2004, petitioners submitted a completed Form 656, Offer in Compromise, to respondent seeking to [*7] resolve their outstanding employment and income tax liabilities for $ 9.024.25, to be paid within 90 days from notice of acceptance of the offer. Upon receipt of the offer-in-compromise, Mr. Conte contacted petitioners to seek additional financial information. Over the course of several months, Mr. Conte and petitioners corresponded on multiple occasions with

respect to additional documents Mr. Conte needed in evaluating petitioners' offer-in-compromise. In one letter to Mr. Conte dated August 13, 2004, petitioners requested that "given that the Bankruptcy Court has failed to render a final accounting to date, the penalties attributable to the principal balance outstanding should be waived." While he was attempting to obtain additional information about petitioners' economic situation, Mr. Conte was also attempting to determine what amount would be paid to respondent from petitioners' bankruptcy estate. Mr. Conte contacted respondent's internal bankruptcy specialists on numerous occasions. Following one such contact, Mr. Conte received an e-mail informing him that "Mr. Salazar owes: IMF $ 13,977.92 and BMF $ 62,786.01 for a total of $76,763.93. The amount that will come to IRS from [*8] the trustee's office * * * [$ 25,000 less trustee expenses] will not full-pay the account (less than 1/3 of balance due). Collection will not be withheld."[2]

According to his case record, Mr. Conte was concerned that accepting an offer-in-compromise while awaiting a final distribution from the bankruptcy might jeopardize respondent's claims to that distribution. Mr. Conte performed research, including reviewing the Internal Revenue Manual (IRM), to assist with his consideration of

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[2] "IMF" refers to respondent's Individual Master File for petitioners' income tax liabilities. "BMF" refers to respondent's Business Master File for Mr. Salazar's employment tax liabilities.

petitioners' offer-in-compromise. Mr. Conte noted the IRM's caution on accepting an offer-in-compromise while awaiting a distribution of assets from a bankruptcy. Mr. Conte also sought and received legal advice on the effect an offer-in-compromise would have on the pending bankruptcy distribution. Counsel from within the Internal Revenue Service (IRS) advised Mr. Conte that acceptance of the offer-in-compromise risked respondent's claim to the distribution and that the offer-in-compromise should be increased by the amount [*9] respondent expected to receive from the bankruptcy.

After receiving counsel's advice, on November 8. 2004, Mr. Conte sent petitioners a letter informing them that –

> I have received guidance from our Counsel regarding the acceptance of an Offer in Compromise in an instance where the distribution of the assets of the bankruptcy has not been completed. This, as you may recall, was the primary issue surrounding your * * * request for an offer.
>
> It is Counsel's opinion, as it is mine, that if the Service were to accept an offer in this instance, the Service would at that point no longer have a claim to any distribution of the bankruptcy proceeds.

> It is also our opinion that the only way that an offer could be accepted under these circumstances, is for the Service to attempt to determine how much of the distribution we would be entitled to and add that to the amount of the offer.

Mr. Conte went on to reason that respondent would likely receive approximately $20,000 from the pending distribution. Accordingly, Mr. Conte informed petitioners that their offer-in-compromise would have to be increased by $20,000 before it could be accepted.

By letter dated November 22, 2004, petitioners responded [*10] that they could not pay the estimated $ 20,000 to respondent that was pending distribution without first receiving the distribution. As an alternative, petitioners offered to relinquish any rights they might have to the distribution for the benefit of respondent. Mr. Conte determined that this offer-in-compromise still risked respondent's forthcoming distribution and thus could not be accepted before receipt of the distribution from the bankruptcy estate. As part of his analysis in his closing memorandum, Mr. Conte noted that if the offer-in-compromise were accepted, any funds remaining after the bankruptcy trustee discharged petitioners' debts would go to other creditors or to petitioners. Mr. Conte concluded: "Based upon informal advice from Counsel and the taxpayer's response, it is Appeals' decision to reject the offer-in-compromise of

$9,024.25 as insufficient due to the fact that a larger amount appears to be collectible."

On January 4, 2005, respondent's Appeals Office issued a Notice of Determination Concerning Collection Action(s) Under *Section 6320* and/or *6330* sustaining the proposed levy action with respect to petitioners' 1997, 1998, and 1999 income tax liabilities. In [* 11] a separate letter addressed only to Mr. Salazar, Mr. Conte indicated that the offer-in-compromise had also been rejected with respect to his outstanding employment tax liabilities.

On February 3, 2005, petitioners filed a petition with this Court seeking review of respondent's determination under docket No. 2203-05L. Petitioners allege that respondent's rejection of their offer to compromise both their outstanding income tax liabilities and Mr. Salazar's employment tax liabilities was an abuse of discretion. Petitioners' petition for docket No. 220305L did not seek to challenge the underlying income tax liabilities that respondent was seeking to collect.

Respondent moved to dismiss for lack of jurisdiction as to Mr. Salazar's employment tax liabilities on the grounds that respondent had never issued a notice of determination concerning a collection action under section 6330 with respect to the employment tax liabilities. In a *Salazar v. Commissioner, T.C Memo. 2006-7*, filed January 18, 2006, we found that no notice of determination for

purposes of *section 6330* had been issued with respect to petitioners' employment tax liabilities and granted respondent's motion to dismiss for lack [* 12] of jurisdiction with respect to Mr. Salazar's employment tax liabilities.[3]

In the interim, on June 20, 2005, the bankruptcy trustee submitted to the bankruptcy court a Trustee's Final Report and Application for Compensation and Reimbursement (the final report). In the final report, payment on respondent's secured claim of $19,915.40 was not allowed. Instead, payment on respondent's priority claim of $43,673.45 was allowed. On August 22, 2005, the bankruptcy trustee disbursed $17,834.51 to respondent.

On August 25, 2005, respondent applied the proceeds of the bankruptcy distribution to Mr. Salazar's outstanding employment tax liabilities for the taxable periods ending December 31, 1998, March 31, 1999, and June 30, 1999. However, the amounts that respondent [* 13] applied to these taxable periods exceeded the priority claims for those periods. On April 24, 2007, respondent adjusted the application of the bankruptcy proceeds to also include partial payments for the taxable

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[3] Respondent also moved to dismiss on the grounds that the Court lacked jurisdiction to hear any challenge to Mr. Salazar's employment tax liabilities. However, because respondent issued a notice of determination with respect to Mr. Salazar's employment tax liabilities on Oct. 18, 2006, respondent admits that we now have jurisdiction to review his determination under sec. 6330(d) (1). *See Callahan v. Commissioner, 130 T.C. __ (2008).*

periods ending September 30, 1999, as well as December 31, 1999.

As of June 30, 2005, Mr. Salazar still had unpaid employment tax liabilities that included:

Period Ending	Unpaid Balance
12/31/98	$ 2,636.81
3/31/99	5,281.02
6/30/99	4,067.44
9/30/99	5,904.60
12/31/99	5,158.55
3/31/00	4,219.10
6/30/00	4,729.82
9/30/00	5,522.11
12/31/00	4,670.33
3/31/01	4,097.97
6/30/01	1,752.20

On February 22, 2006, respondent issued a Final Notice of Intent to Levy and Notice of Your Right to a Hearing with respect to Mr. Salazar's employment tax liabilities. In response, Mr.

Salazar submitted a second Form 12153 with respect to the proposed collection action on the employment tax liabilities. The new request for collection review was assigned to Appeals Settlement Officer Thomas Conley. In his initial correspondence with Mr. Conley, Mr. Salazar indicated that he did not intend to submit a new offer-in-compromise but instead sought reconsideration of petitioners' original offer-in-compromise of $9,024.25. Mr. Salazar [*14] also attempted to challenge the assessment of penalties and interest during the pendency of petitioners' bankruptcy as well as the manner in which respondent applied the bankruptcy proceeds. [4]

On May 17, 2006, petitioners had an in-person hearing with Mr. Conley. On June 20, 2006, Mr. Salazar submitted a new offer-in-compromise. The basis of the new offer-in-compromise was again doubt as to collectibility, and the new offer included updated financial information. Mr. Salazar offered to compromise petitioners' then-outstanding income and employment tax liabilities for $19,547.13. By this time, Mrs. Salazar was working as an attorney and Mr. Salazar as a manager of a restaurant. Mr. Salazar had also begun collecting monthly Social Security benefits. Mr. Conley determined that petitioners' reasonable collection potential exceeded the outstanding liabilities and thus rejected the offer-in-compromise. Mr. Conley's determination did not, however, address Mr. Salazar's claims that respondent was seeking to collect penalties and

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[4] Respondent's notice of intent to levy did not include the periods ending Dec. 31, 1998, or Mar. 31, 1999.

interest assessed for the period while petitioners' bankruptcy [* 15] petition was pending.

On October 18, 2006, respondent issued a Notice of Determination and Collection Action Under *Section 6320* and/or *6330* to Mr. Salazar regarding his employment tax liabilities. Mr. Salazar then filed a second petition to this Court claiming error in respondent's determination to proceed with collection in the case at docket No. 23547-06L. The second petition does not allege any error with respect to respondent's rejection of Mr. Salazar's second offer-in-compromise. Instead, Mr. Salazar again alleges that respondent abused his discretion in failing to revisit and accept petitioners' original 2004 offer-in-compromise. Mr. Salazar also alleges error by respondent in not abating the penalties and interest assessed for the period while petitioners' bankruptcy petition was pending. Finally, Mr. Salazar alleges that it was an error for respondent to apply the bankruptcy proceeds to his individual employment tax liabilities instead of petitioners' joint income tax liabilities. The two petitions have been consolidated for trial, briefing, and opinion.

OPINION

I. *Introduction*

While this matter has developed in a manner that has made it more complicated than necessary, in the [* 16] end it is a collection review case in which petitioners principally sought to resolve their

outstanding income and employment tax liabilities through an offer-in-compromise. Petitioners offered to settle all of their outstanding liabilities, including the income tax liabilities and the employment tax liabilities, for $9,024.25. Respondent rejected the offer-in-compromise because he was likely to receive more from the petitioners' pending bankruptcy. Petitioners want the Court to determine that respondent's rejection was an abuse of discretion and that respondent be compelled to accept the offer-in-compromise with respect to both the income taxes and the employment taxes. We find that respondent did not abuse his discretion.

Section 6330 provides that no levy may be made on any property or right to property of a person unless the Secretary first notifies him in writing of the right to a hearing before the Appeals Office. At the hearing, the taxpayer may raise any relevant issues relating to the unpaid tax or the proposed levy, including appropriate spousal defenses, challenges to the appropriateness of collection actions, and collection alternatives. *Sec. 6330(c)(2)(A).* A taxpayer may [* 17] contest the existence or amount of the underlying tax liability if the taxpayer failed to receive a notice of deficiency for the tax liability in question or did not otherwise have an earlier opportunity to dispute the tax liability. *Sec. 6330(c)(2)(B); see also Sego v. Commissioner, 114 T.C. 604, 609 (2000).*

Following a hearing, the Appeals Office must make a determination whether the Secretary may

proceed with the proposed collection action. We have jurisdiction to review the Appeals officer's determination. *Sec. 6330(d)(1).* Where the underlying tax liability is properly at issue, we review that determination de novo. *Goza v. Commissioner, 114 T.C. 176, 181-182 (2000).* Where the underlying tax liability is not at issue, we review the determination for an abuse of discretion. *Id at 182.*

II. *Offers-in-Compromise*

Petitioners first seek to compel respondent's acceptance of their offer-in-compromise. Petitioners suggest that the failure to accept their original offer-in-compromise was an abuse of discretion.

We do not conduct an independent review of what would be an acceptable offer-in-compromise. *Murphy v. Commissioner, 125 T.C. 301, 320 (2005), affd. 469 F.3d 27 (1st Cir. 2006); Fowler v. Commissioner, T.C. Memo. 2004-163.* [* 18] The extent of our review is to determine whether the Appeals officer's decision to reject the taxpayer's offer-in-compromise was arbitrary, capricious, or without sound basis in fact or law. *Skriaowski v. Commissioner, T.C. Memo. 2004-229; Fowler v. Commissioner, supra.*

Section 7122(a) authorizes the Commissioner to compromise any civil or criminal case arising under the internal revenue laws. See Fargo v. Commissioner, 447 F.3d 706, 712 (9th Cir. 2006)

(noting that the authorization to compromise any civil or criminal case is discretionary), affg. T.C. Memo. 2004-13. Section 7122(c) provides that the Commissioner shall prescribe guidelines for evaluation of whether an offer-in-compromise should be accepted. *See sec. 301.7122-1(c)(1)*, Proced. & Admin. Regs.

The *section 7122 regulations* set forth grounds for the compromise of a taxpayer's liability, including doubt as to collectibility. *Sec. 301.7122-1(b)*, Proced. & Admin. Regs. Doubt as to collectibility exists in any case where the taxpayer's assets and income are less than the full amount of the liability. *Sec. 301.7122-1(b)(2)*, Proced. & Admin. Regs. Generally, under the Commissioner's administrative pronouncements, an offer to compromise [* 19] based on doubt as to collectibility will be acceptable only if it reflects the reasonable collection potential of the case; i.e., that amount, less than the full liability, that the IRS could collect through means such as administrative and judicial collection remedies. *Rev. Proc_ 2003-71*, sec. 4.02(2), *2003-2 C.B. 517, 517*. The offer-in-compromise must include all unpaid tax liabilities and periods for which the taxpayer is liable. 1 Administration, IRM (CCH), pt. 5.8.1.7, at 16,256.

If an offer-in-compromise is submitted where a taxpayer has also filed a bankruptcy petition, the Commissioner cautions against acceptance of the offer-in-compromise in the window between a taxpayer's discharge in bankruptcy and the time the final distribution is made because "it is

uncertain whether the Service would still have a valid claim in bankruptcy if an offer is accepted." 1 Administration, IRM (CCH), pt. 5.8.10.2.3(2), at 16,368. Thus, the Internal Revenue Manual guidelines advise that the amount acceptable for an offer should include the amount we reasonably expect to recover from the bankruptcy in addition to what can be collected from the taxpayer on non-discharged liabilities or from property [*20] outside the bankruptcy." Id.

It is clear from the administrative record that Mr. Conte was concerned that accepting petitioners' $9,024.25 offer-in-compromise would risk respondent's expected distribution from the bankruptcy. Mr. Conte had extended contact with respondent's bankruptcy specialists. He also performed his own research, including reviewing the IRM guidelines. Mr. Conte sought to determine the likely amount respondent would receive from the bankruptcy and the effect accepting a compromise would have on respondent's distribution. Ultimately, Mr. Conte concluded that respondent was likely to receive approximately $20,000 of the $25,000 remaining in the bankruptcy. Further, as advised by counsel, Mr. Conte concluded that accepting the offer-in-compromise risked respondent's claims in the bankruptcy estate. Thus, in accordance with the IRM and advice from counsel, Mr. Conte determined that petitioners' offer-in-compromise was inadequate because it was less than what respondent expected to receive from the bankruptcy

trustee and because accepting that offer would place that distribution at risk.

Petitioners argue that respondent's rejection of the offer-in-compromise was based [*21] on an erroneous conclusion of law that the bankruptcy distribution was at risk. Petitioners argue that respondent's distribution from the bankruptcy was never at risk. If respondent's determination was based upon an erroneous conclusion of law, we must reject that view and find that respondent abused his discretion. *See Swanson v. Commissioner, 121 T.C. 111, 119 (2003).*

As respondent's counsel now explains, an offer-in-compromise must include all of the outstanding liabilities of the taxpayer. Further, *section 6325(a)* provides that the Commissioner "shall issue a certificate of release of any lien imposed with respect to any internal revenue tax" not later than 30 days after the liability for the amount has been fully satisfied. Thus respondent argues, if respondent were to accept an offer-in-compromise and the liabilities were thereby fully satisfied, he would jeopardize any secured claim to the bankruptcy distribution. Accordingly, as respondent's counsel argues, an offer-in-compromise will not be accepted while a bankruptcy is pending if the offer is less than the amount he reasonably stands to receive when the bankruptcy distribution occurs.

We believe, however, that respondent's [*22] risk, or at least his perceived risk, goes beyond

simply the release of any secured claim he has to the bankruptcy distribution. If an offer-in-compromise must include all of the outstanding liabilities of the taxpayer, then acceptance and satisfaction of the offer would risk, if not extinguish, all claims the Commissioner had to the bankruptcy assets. The administrative record suggests it was this more generalized risk, to all of respondent's claims, that concerned Mr. Conte in evaluating petitioners' offer-in- compromise. Nonetheless, petitioners fail to point to any authority to suggest that respondent's position that accepting an offer-in-compromise jeopardized the bankruptcy distribution was without legal basis, and the Court knows of none.

In furtherance of their argument that the bankruptcy distribution was not at risk, petitioners highlight their offer to relinquish any claim to the bankruptcy distribution for the benefit of respondent. While this offer would have reduced the risk that petitioners would receive a windfall from the bankruptcy by virtue of the offer-in-compromise, it did nothing to reduce respondent's risk with respect to other creditors. As Mr. Conte explained [*23] in his closing memorandum: if the offer-in-compromise were accepted, any remaining funds in the bankruptcy "would go to other creditors or to the taxpayer." Petitioners again fail to present any authority to suggest that their other creditors would be precluded from objecting to any distribution to respondent after the acceptance of their offer-in-compromise.

Petitioners make two additional arguments on why respondent's determination was an abuse of discretion. First, petitioners suggest that respondent was announcing a bright-line rule and did not exercise discretion at all. Second, petitioners argue that respondent abused his discretion because he rejected the offer-in-compromise solely on the basis of the amount offered in contravention of *section 7122(d)(3)*. We address each in turn.

Petitioners first take issue with Mr. Conte's requirement that their offer-in-compromise be increased by the amount of the expected distribution from the bankruptcy. The IRM guidelines instruct that an acceptable offer-in-compromise would have to include the amount that respondent expected to receive from the bankruptcy in addition to what respondent could collect from petitioners directly. Petitioners [*24] argue that by relying upon this provision of the IRM, the Appeals officer was not exercising discretion at all but instead enunciating a bright-line rule for all postdischarge bankruptcy cases where the Commissioner is waiting for a distribution. *See Estate of Roski v. Commissioner, 128 T. C. 113 (2007)* (holding that by requiring all estates to post a bond to make a section 6166 election regardless of the facts before him, the Commissioner was adopting a bright-line policy that trumped the exercise of his discretion).

Mr. Conte's use of the IRM was not, however, a de facto enunciation of a bright-line rule that

trumped the exercise of discretion. In evaluating an offer-in-compromise under doubt as to collectibility, the Commissioner must first determine the reasonable collection potential on the amount owed. *Rev. Proc. 2003-71*, sec. 4.02(2). In the ordinary circumstance, the Commissioner calculates the reasonable collection potential by determining the excess of a taxpayer's assets and future income above certain allowances for basic living expenses. *See Klein v. Commissioner, T. C. Memo. 2007-325.* The guidelines aid the Commissioner in this endeavor. *Id.*; *see also, e.g., McDonough v. Commissioner, T.C. Memo. 2006-234*; [*25] *Etkin v. Commissioner, T.C. Memo. 2005-245*; *Schulman v. Commissioner, T.C. Memo. 2002-129.* A pending bankruptcy petition changes this collection analysis because the taxpayer has surrendered his assets to the bankruptcy court. Thus, where a taxpayer has filed for bankruptcy, the Commissioner stands to collect as a creditor in the bankruptcy proceeding in addition to possibly collecting from the taxpayer directly from future income and assets not subject to the bankruptcy.

Thus, at first, the IRM instructs a settlement officer to consider the Commissioner's standing as a creditor in the bankruptcy and advises that an acceptable offer-in-compromise include the amount the Commissioner reasonably expects to recover from the bankruptcy. 1 Administration, IRM (CCH), pt. 5.8.10.2.3(2). In other words, the Appeals officer should not accept an offer of $5 when doing so will risk the likely receipt of $10 down the road. Second, the IRM instructs that an

acceptable offer-in-compromise should also include the amount that "can be collected from the taxpayer on non-discharged liabilities or from property outside the bankruptcy." *Id.* Thus, if the Commissioner stands to receive $10 as a creditor [*26] in the bankruptcy and, in addition, $5 can be collected directly from the taxpayer, then the reasonable collection potential is not $5 or even $10, but more like $15.

Mr. Conte did not have to reach the second part of this analysis -- the amount respondent could collect from petitioners outside of the bankruptcy. The $9,024.25 offer-in-compromise from petitioners was less than the $20,000 Mr. Conte expected respondent would receive from the bankruptcy, and he determined that acceptance of the offer would risk the receipt of that $20,000. We find that Mr. Conte was not enunciating a bright- line rule for all cases. Mr. Conte was simply applying respondent's guidelines on evaluating offers-in-compromise, including the reasonable collection potential, to the specifics of petitioners' offer.

Finally, petitioners argue that respondent abused his discretion by rejecting petitioners' offer-in-compromise solely on the basis of the amount offered. *Section 7122(d)(3)(A)* provides: "an officer or employee of the Internal Revenue Service shall not reject an offer-in-compromise from a low-income taxpayer solely on the basis of the amount of the offer". The regulations expand on this by stating [*27] that "No offer to compromise may be rejected solely on the basis of the amount of the

offer without evaluating that offer under the provisions of this section and the Secretary's policies and procedures regarding the compromise of cases." *Sec. 301. 7122-1(f) (3)*, Proced. & Admin. Regs.

The administrative record makes clear that Mr. Conte did not reject petitioners' offer-in-compromise solely on the basis of the amount offered, $9,024.25. Mr. Conte used respondent's policies and procedures -- the guidelines of the IRM as well as advice received from counsel -- to evaluate the specifics of petitioners' offer in the light of what respondent could reasonably expect to collect on petitioners' liabilities. Mr. Conte concluded that respondent was likely to receive more in the distribution from the bankruptcy than from petitioners' offer-in-compromise. Further, Mr. Conte determined that accepting petitioners' offer would risk this expected greater distribution. We find petitioners' offer-in-compromise was not rejected solely on the basis of the amount offered.

We are not unsympathetic to petitioners' situation as they ultimately had no control over when any distribution from the bankruptcy would [*28] be made. Since then, petitioners' financial outlook has improved dramatically. Mr. Salazar is now employed as a manager of a restaurant and has begun receiving Social Security benefits. Mrs. Salazar completed law school and now works as an attorney. Thus, while the $9,024.25 offer-in -- compromise may have been the limit of what petitioners could pay in 2004, when Mr. Salazar

submitted a second offer-in-compromise during the second collection review hearing with respect to his employment tax liabilities, respondent determined that Mr. Salazar was then in a position to pay the entirety of his outstanding employment tax liabilities. Petitioners have not presented any argument or evidence to the Court to suggest that respondent's rejection of this second offer-in-compromise was an abuse of discretion.

In sum, we find that respondent did not abuse his discretion in rejecting petitioners' offers-in-compromise.

III. *Underlying Liability*

To the extent the Court does not compel respondent to accept their original offer-in-compromise, petitioners argue in the alternative that respondent's assessment of penalties and interest while their bankruptcy petition was pending was erroneous. Petitioners [*29] also argue that respondent erroneously applied the bankruptcy proceeds to the individual employment tax liabilities of Claude Salazar instead of their joint income tax liabilities.

In a collection review proceeding, a taxpayer may raise challenges to the existence or amount of the underlying liability for any tax period if the person did not receive any statutory notice of deficiency for such tax liability or did not otherwise have an opportunity to dispute the underlying liability. *Sec. 6330(c)(2)(B)*. Where a taxpayer has

filed a bankruptcy action, and the Commissioner has submitted a proof of claim for unpaid Federal tax liabilities in a taxpayer's bankruptcy action, we have held that the taxpayer has had the opportunity to dispute the liabilities for purposes of *section 6330(c)(2)(B). See Kendricks v. Commissioner, 124 T.C. 69 (2005); Sabath v. Commissioner, T.C. Memo. 2005-222.* A bankruptcy court may consider the amount or legality of taxes, including penalties and interest. *11 U.S.C. sec. 505 (a) (2000); Sabath v. Commissioner, supra.*

In petitioners' bankruptcy proceeding, respondent submitted a proof of claim for petitioners' unpaid income tax and employment tax liabilities, including [*30] penalties and interest. Petitioners, while represented by counsel, did not file an objection to these tax liabilities. Accordingly, petitioners are precluded from challenging their underlying liabilities, including the penalties and interest. However, even if petitioners had raised the issue of whether respondent's assessment of penalties and interest during their bankruptcy proceeding was erroneous, to the extent that respondent has not conceded this issue, we would sustain his assessment of penalties and interest.

Section 6658(a) provides that "No addition to the tax shall be made under section *6651*, *6654*, or *6655* for failure to make timely payment of tax with respect to a period during which a case is pending under title 11 of the United States Code".

Petitioners' bankruptcy was pending from the date they filed their petition until their case was closed on March 30, 2006. *See Rev. Rul. 2005-9, 2005-1 C.B. 470.*

Respondent admits having erroneously assessed a failure to pay penalty with respect to petitioners' 1997 income tax account on October 23, 2003, while petitioners' bankruptcy was pending. Respondent has agreed to correct this error. Petitioners did not present any evidence that [*31] respondent assessed penalties for their 1998 and 1999 income tax liabilities while their bankruptcy petition was pending. Further, a review of petitioners' income tax account transcripts for 1998 and 1999 confirms that respondent did not assess any additional penalty during the pendency of their bankruptcy.

With respect to the employment tax liabilities for Mr. Salazar under docket No. 23547-06L, petitioners again argue that additions to tax were sought for the period their bankruptcy was pending. However, *section 6658* does not prevent respondent from assessing the additions to tax during the pendency of the bankruptcy related to employment taxes to the extent that they are withheld or collected from others. *Sec. 6658(b)*; *Kiesner v. IRS, 194 Bank. 452, 458 (Bankr. E.D. Wis. 1996)*; see also S. Rept. 96-1035, at 51 (1980), *1980-2 C.B. 620, 646* ("These relief rules do not, however, apply with respect to liability for penalties for failure to timely pay or deposit any employment tax required to be withheld by the

debtor or trustee."). Accordingly, we find no basis to suggest that the employment tax liabilities respondent seeks to collect include any erroneously assessed additions to tax.

Petitioners [*32] also argue for abatement of interest on both their income tax and employment tax liabilities. The Commissioner is not prevented from seeking interest for the period a taxpayer's bankruptcy proceeding is pending. *Sec. 6658 (a)*; see also, e.g., *Woodward v. United States, IRS (In re Woodward), 113 B.R 680, 684 (Bank-r. D. Or. 1990)*. Under *section 6404(a)*, the Commissioner is granted the discretion to abate the assessment of any tax or liability that is excessive in amount, assessed after the expiration of the period of limitation, or erroneously assessed. But see *sec. 6404 (b)* ("No claim for abatement shall be filed by a taxpayer in respect of an assessment of any tax imposed under subtitle A or B."). *Section 6404(e)* authorizes the Commissioner to abate interest assessments that are attributable to errors or delays by the IRS.

Petitioners do not argue that the interest is excessive or was erroneously assessed under *section 6404(a)*. Instead, petitioners argue for abatement of interest because of the delay in the distribution of funds from the bankruptcy. While in certain circumstances interest may be abated because of an unreasonable delay of the Commissioner, respondent was no more in control over the distribution [*33] of the bankruptcy proceeds than were petitioners. We find that the delay in the

distribution of proceeds by the bankruptcy trustee is not grounds for the abatement of interest under *section 6404* or for otherwise relieving petitioners from liability for the interest.

Finally, under docket No. 23547-06L,[5] petitioners challenge respondent's application of the bankruptcy proceeds to the employment tax liabilities of Mr. Salazar instead of the joint tax liabilities of both petitioners. Because the distribution occurred after the bankruptcy proceeding was closed, and Mr. Salazar raised it during the hearing, we may review this issue.

At the time of the bankruptcy trustee's final report, respondent possessed: (1) A secured claim of $19,915.40 for petitioners' 1997 and 1998 tax liabilities; (2) an unsecured priority claim of $43,673.45 for petitioners' 1999 income tax liabilities and Mr. Salazar's 1998, 1999, 2000, and 2001 employment tax liabilities; and (3) an unsecured general claim of $8,850.74. However, only payment [*34] on respondent's $43,673.45 priority claim was allowed by the bankruptcy trustee.

Respondent applied the $17,834.51 that was ultimately disbursed by the bankruptcy trustee on August 22, 2005, to the employment tax liabilities of Mr. Salazar that made up part of respondent's priority claim. At first respondent applied the

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[5] The trustee had not filed his final report nor had any disbursements been made at the time of petitioners' collection review hearing with respect to their joint liabilities.

disbursement to the employment tax periods ending December 31, 1998, March 31, 1999, and June 30, 1999, in amounts that exceeded respondent's priority claims for those periods. Eventually, respondent corrected this application of the proceeds to also include partial payments on the priority claims for the periods ending September 30, 1999, and December 31, 1999.

Petitioners claim that respondent should have applied the disbursement to petitioners' joint income tax liabilities first instead of just Mr. Salazar's employment tax liabilities. Where a taxpayer makes voluntary payments to the IRS, he does have the right to direct the application of payments to whatever type of liability he chooses. See, e.g., *Estate of Wilson v. Commissioner, T. C. Memo. 1999-221.* However, where a taxpayer makes an involuntary payment, the IRS may allocate or reallocate the payment as it sees [*35] fit, regardless of a taxpayer's designation. As we have stated: "An involuntary payment of Federal taxes means any payment received by agents of the United States as a result of distraint or levy or from a legal proceeding in which the Government is seeking to collect its delinquent taxes or file a claim therefor." *Amos v. Commissioner, 47 T.C. 65, 69 (1966)*; see also *United States v. Pepperman, 976 F.2d 123, 127 (3d Cir. 1992)* (noting that most courts to have considered the issue have concluded that payments made in the bankruptcy context are involuntary). In the light of the involuntary nature of the bankruptcy distribution, we find no error in respondent's application of the proceeds to the

employment tax liabilities of Mr. Salazar before the joint income tax liabilities of both petitioners. In any event, there is no evidence that petitioners specified in writing that the proceeds be applied to their income tax liability instead.

On the basis of the record before the Court, and with the exception of the failure to pay penalty for income tax year 1997 which respondent concedes, petitioners are liable for the taxes, additions to tax, and interest as determined by respondent. We further [*36] find that respondent did not abuse his discretion in rejecting petitioners' offers-in-compromise. Thus, respondent's determination that the Federal tax levies were appropriate in these cases is sustained.

To reflect the foregoing,

Decision in docket No. 2203-05L will be entered under Rule 155.

Decision in docket No. 2354 7-06L will be entered for respondent.

UNITED STATES TAX COURT
WASHINGTON, D.C. 20217

CLAUDE E. and DANA L. SALAZAR, ET AL. *

Petitioners, *

V. *

COMMISIONER OF INTERNAL REVENUE *

Respondent.

Docket Nos. 2203-05L, 23547-06L.

ORDER

For cause, it is

ORDERED that these docketed cases are hereby severed.

s/_____

Joseph R. Goeke
Judge

DATED: Washington, D.C.
March 4, 2008

UNITED STATES TAX COURT
WASHINGTON, D.C. 20217

CLAUDE E. SALAZAR

*

Petitioner,

*

V.

*

COMMISSIONER OF INTERNAL REVENUE *

Respondent.

Docket No. 23547-06L

DECISION

Pursuant to the determination of the court as set forth in its memorandum Findings of Fact and opinion, filed February 25, 2008 (T.C. Memo 2008-38), it is

ORDERED and DECIDED that respondent may proceed with the collection action as determined in the Notice of Determination Concerning Collection Action(s) Under Section 6320 and/or 6330 for the tax periods ending June 1999, September 1999, December1999, March 2000, June 2000, September 2000, December 2000,March 2001, and June 2001.

s/
Joseph R.
Goeke
Judge

ENTERED: Mar 12 2008

UNITED STATES TAX COURT
WASHINGTON, D.C. 20217

CLAUDE E. and DANA L. SALAZAR *

Petitioners, *

V. *

COMMISSIONER OF INTERNAL REVENUE *

Respondent.

Docket No. 2203-05L

DECISION

Pursuant to the Memorandum Findings of Fact and opinion this Court (T.C. Memo, 2008-38, filed February 25, 2008, the parties are to file either agreed or separate computations under Rule 155 in this docketed case.

On April 18, 2008, respondent filed a Computation for Entry of Decision, accompanied by a proposed decision document. On May 5, 2008, petitioners filed a Computation for Entry of Decision, accompanied by a proposed decision document.

By Order dated May 12, 2008, the Court directed respondent on or before May 30, 2008, to file a written status report informing the Court as

to whether there is any objection to petitioners' request that the $1,216.52 overpayment be applied to petitioners' joint 1040 liability for the tax year 1998 as of the date of the overpayment. This overpayment resulted from respondent's erroneous assessment of an additional $1,216.52 failure to file penalty for petitioners' tax period ending December 31,1997. However, respondent conceded that this penalty was assessed in error because at the time it was assessed, petitioners' bankruptcy petition was pending.

On May 23, 2008, respondent filed a Status Report agreeing to stipulate that the $1,216.52 overpayment be applied to petitioners' joint 1040 liability for the tax year 1998 as of the date of the overpayment.

Given due consideration to the foregoing, and in reviewing both parties' computations and respondent's written status report, it is hereby

ORDERED and DECIDED that the determinations set forth in the Notice of Determination Concerning Collection Action Under Section 6320 and/or 6330 issued to petitioners on January 4, 2005, for petitioners' income tax liabilities for taxable years 1997, 1998, and 1999, upon which this case is based, are sustained except as provided herein.

The tax imposed on petitioners by the Internal Revenue Code for taxable years 1997, 1998, and 1999, are as follows:

Year	Income tax	Additions to Tax Sec. 6651(a)(2)	Sec 6654
1997	$166,460.00	$467.08	$2,354.00
1998	3,821.00	144.24	164.00
1999	4,487.00	201.91	192.00

Interest is not included in the above-referenced tax liabilities, and that interest will be assessed as provided by law on tax liabilities.

s/
Joseph R. Goeke
Judge

ENTERED: JUN - 2 2008

CLAUDE E. AND DANA L. SALAZAR, Petitioners v. COMMISSIONER OF INTERNAL REVENUE, Respondent

No. 2203-05L

UNITED STATES TAX COURT

T.C. Memo 2006-7; 2006 Tax Ct. Memo LEXIS 8; 91 T.C.M. (CCH) 659

January 18, 2006, Filed

SUBSEQUENT HISTORY: Findings of fact/conclusions of law at *Salazar v. Comm'r, T.C. Memo 2008-38, 2008 Tax Ct. Memo LEXIS 38 (T. C, 2008)*

COUNSEL: [*1] Jeremy H. Speich and Vincent L. Valenza, for petitioners.

Diana P. Hinton, for respondent.

JUDGES: Marvel, L. Paige

OPINION BY: L. PAIGE MARVEL

OPINION

MEMORANDUM OPINION

MARVEL, Judge: This matter is before the Court on respondent's motion to dismiss for lack of jurisdiction and to, strike as to Mr. Salazar's employment tax liabilities for the quarters ended December 1998 through June 2001 on the grounds that (1) respondent never issued a notice of determination concerning a collection action under *section 6330* [1] with respect to the employment tax liabilities, and (2) the Tax Court does not have jurisdiction over Mr. Salazar's employment tax liabilities.

Background

Petitioners resided in Nassau, New York, when their petition was filed.

From April 1995 until at least sometime in 2001, petitioners operated a sole proprietorship, Artistic Nature.[2] In January 2001, petitioners filed a chapter 7 bankruptcy petition. [*2] On July 25, 2002, the U.S. Bankruptcy Court discharged petitioners from all dischargeable debts. However, at the time of the hearing in the instant case on respondent's motion to dismiss, petitioners had not yet received a final accounting and distribution ' from the U.S. Trustee.[3]

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[1] All section references are to the Internal Revenue Code in effect at the time the petition was filed.

[2] Although both petitioners operated the business, the employment tax liabilities appear in Mr. Salazar's name only, and we address them as such here.

[3] Petitioners anticipate receiving a distribution of approximately $20,000 from the U.S. Trustee after fees and expenses.

On a date that does not appear in the record, petitioners received a Notice of Intent To Levy and Notice of Your Right to a Hearing from respondent.[4] On December 16, 2003, petitioners filed a Form 12153, Request for a Collection Due Process Hearing, with respect to their unpaid employment and income tax liabilities for the years 1997 through 2001. On their Form 12153, petitioners requested additional time to enable the U.S. Trustee to complete the final [*3] accounting regarding the bankruptcy estate and to make final distribution in the bankruptcy case. Petitioners intend to apply any distribution they receive to their outstanding tax liabilities.

On or about May 10, 2004, petitioners sent a completed Form 656, Offer in Compromise, to respondent, offering to compromise specified Federal tax liabilities for $9,024.25. The offer-in-compromise covered petitioners' income tax liabilities for 1997, 1998, and 1999 and Mr. Salazar's employment tax liabilities for the quarters ending December 31, 1998, through September 30, 1999, and March 31, 2000, through June 30, 2001.[5]

[*4] By letter dated May 14, 2004, respondent scheduled petitioners' Appeals Office

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[4] The record does not indicate for which of petitioners' tax liabilities the notice of intent to levy was sent.

[5] Petitioners contend that they offered to compromise Mr. Salazar's unpaid employment tax liabilities for all quarters ending Dec. 31, 1998, through June 30, 2001. However, petitioners did not include the quarter ended Dec. 31, 1999, on the Form 656, Offer in Compromise, they submitted.

hearing for June 3, 2004. According to the letter, only petitioners' 1997-99 income tax liabilities were at issue.

The record does not indicate whether the parties met on June 3, 2004. From June 16 through December 3, 2004, however, petitioners' counsel and respondent's counsel exchanged several letters and extensive documentation relating to petitioners' offer-in-compromise. By letter dated November 8, 2004, respondent informed petitioners' counsel that petitioners must increase their offer-in-compromise by the amount of the prospective bankruptcy distribution in order to protect respondent's interest in the distribution proceeds. By letter dated November 22, 2004, petitioners' counsel objected to an increase in the offer-in-compromise and instead offered to execute an agreement assigning petitioners' future rights to the prospective distribution to respondent.

On January 4, 2005, respondent rejected petitioners' offer-in- compromise and issued a Notice of Determination Concerning Collection Action(s) Under *Section 6320* and/or *6330* (notice of determination) sustaining the proposed levy action with respect [*5] to petitioners' 1997, 1998, and 1999 income tax liabilities.[6] On February 3, 2005,

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[6] Attached to the notice of determination in the record are two rejection letters from respondent. One letter rejects the offer-in-compromise for the years 1997, 1998, and 1999. The other rejects the offer for the quarters ending December 1998 through June 2001. However, the notice of determination covers only the income tax liabilities for years 1997, 1998, and 1999.

the petition in this case was filed. In the petition, petitioners contended that respondent's rejection of their offer to compromise both their delinquent income tax liabilities and Mr. Salazar's employment tax liabilities was an abuse of discretion.

Discussion

Section 6330(a) provides that no levy may be made on any property or right to property of any person unless the Secretary has notified such person in writing of the right to a hearing before the levy is made. If the person makes a timely request for a hearing, a hearing shall be held by the Internal Revenue [*6] Service Office of Appeals (Appeals Office). *Sec. 6330(b) (1).*

When the Appeals Office issues a notice of determination to a taxpayer following a *section 6330* hearing, the taxpayer has 30 days following the issuance of the notice to file a petition for review of the determination with the Tax Court or, if the Tax Court lacks jurisdiction over the underlying tax liability, with a Federal District Court. *Sec. 6330(d).* If a court determines that the taxpayer appealed to an incorrect court, the taxpayer will have 30 days after such determination to file an appeal with the correct court. Id.

This Court is a court of limited jurisdiction, and it may exercise its jurisdiction only to the extent authorized by Congress. *Sec. 7442*; *Moore v. Commissioner, 114 T. C. 171, 175 (2000)*; *Naftel v. Commissioner, 85 T.C. 527, 529 (1985)*. This Court generally has deficiency jurisdiction over income, gift, and estate tax cases. See *secs. 6211(a), 6213 (a), 6214(a)*; *Downing v. Commissioner, 118 T.C. 22, 27 (2002)*; *Van Es v. Commissioner, 115 T.C. 324, 328 (2000)*. For purposes of *section 6330(d)*, this Court may have jurisdiction over an underlying liability [*7] for income, estate, or gift tax even when no deficiency has been determined. *Montgomery v. Commissioner, 122 T.C. 1, 7-8 (2004)*; *Downing v. Commissioner, supra at 27-28*; *Landry v. Commissioner, 116 T. C. 60, 62 (2001)*. However, the Court's jurisdiction over collection matters under section 6330(d)(1) is limited to the types of tax over which it normally has jurisdiction. See *Van Es v. Commissioner, supra at 328-329*; *Moore v. Commissioner, supra at 175*.

Section 7436(a) confers jurisdiction over employment tax liabilities on this Court, but the Court's jurisdiction is limited to controversies involving a worker's employment status.[7] See *Charlotte's Office Boutique v. Commissioner, 121 T. C. 89, 102-103 (2003)*, supplemented by *T. C. Memo 2004-83, T. C. Memo. 2004-43*, affd. *425 F. 3d 1203 (9th Cir. 2005)*; *Ewens & Miller, Inc. v. Commissioner, 117 T.C. 263, 267 (2001)*.

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[7] *Sec. 7436(a)* was amended by the Consolidated Appropriations Act of 2001, Pub. L. 106-554, sec. 314(f), 114 Stat. 2763A-643, to confer such jurisdiction.

Respondent argues that this Court lacks jurisdiction over Mr. Salazar's employment tax liabilities because respondent did not issue a notice of determination regarding the unpaid employment tax liabilities and because there is [*8] no dispute over employment status. Respondent also argues that he did not make a determination concerning employment status. We agree with respondent

It is undisputed that petitioners did not receive a formal notice of determination from respondent with respect to Mr. Salazar's employment tax liabilities. Petitioners argue, however, that respondent's January 4, 2005, rejection letter addressing petitioners' offer-in-compromise for the employment tax periods, which was sent in the same envelope as the notice of determination for the income tax liabilities, is sufficient to constitute a determination with respect to the employment tax liabilities for purposes of *section 6330*. Alternatively, petitioners contend that respondent should be compelled to issue a notice of determination with respect to Mr. Salazar's employment tax liabilities because petitioners included [*9] those liabilities in their request for a *section 6330* hearing.

Under *section 6330(c)(2)(A)*, a taxpayer may raise at a section 6330 hearing any relevant issue relating to the unpaid tax or the proposed levy, including appropriate spousal defenses, challenges to the appropriateness of collection action, and offers of collection alternatives. Under some circumstances, a taxpayer may also challenge the

existence or amount of the underlying tax liability. *Sec. 6330(c)(2)(B).* After the hearing, the Appeals officer who presided over the hearing is required to issue a notice of determination that must set forth the officer's findings and decisions, including the following:

> [T]he Notice of Determination] will state whether the IRS met the requirements of any applicable law or administrative procedure; it will resolve any issues appropriately raised by the taxpayer relating to the unpaid tax; it will include a decision on any appropriate spousal defenses raised by the taxpayer; it will include a decision on any challenges made by the taxpayer to the appropriateness of the collection action; it will respond to any offers [* 10] by the taxpayer for collection alternatives; and it will address whether the proposed collection action represents a balance between the need for the efficient collection of taxes and the legitimate concern of the taxpayer that any collection action be no more intrusive than necessary. The Notice of Determination will also set forth any agreements that Appeals reached with the taxpayer, any relief given the taxpayer, and any actions the taxpayer or the IRS are required to take. Lastly, the Notice of Determination will advise the taxpayer of the taxpayer's right to seek judicial review within 30 days of the date of the Notice of Determination.

Sec. 301.6330-1(e)(3), Q&A-E8, Proced. & Admin. Regs. In deciding whether we have jurisdiction over a proceeding filed pursuant to section 6330, we have held that a notice of determination includes a "written notice that embodies a determination to proceed with the collection of the taxes in issue." *Sapp v. Commissioner, T. C. Memo. 2003-207* (citing *Lunsford v. Commissioner, 117 T. C. 159, 164 (2001)*); see also *Craig v. Commissioner, 119 T.C. 252, 259 (2002)*. [*11]

Respondent's rejection letter addressing Mr. Salazar's employment tax liabilities does not include the information that a notice of determination is required to include. See *sec. 301.6330-1(e)(3), Q &A-E8*, Proced. & Admin. Regs. For example, the letter does not address the requirements of applicable law or administrative procedure, the balance between the efficient collection of taxes and the intrusiveness of the proposed levy, or any appellate procedure available to petitioners. The rejection letter also fails to state that respondent intends to proceed with the collection of taxes in issue. The letter simply rejects petitioners' offer-in-compromise and requests that petitioners voluntarily pay their account in full. We conclude, therefore, that the rejection letter is not a notice of determination for purposes of *section 6330* and that we lack jurisdiction over petitioners' claim regarding Mr. Salazar's employment tax liabilities under *section 6330*.

Section 7436(a), which gives us limited jurisdiction over employment tax disputes regarding a worker's employment status, does not solve the jurisdictional problem that petitioners present, nor does it serve as an independent basis for [* 12] asserting jurisdiction over Mr. Salazar's employment tax liabilities. The issue raised in the petition does not involve any dispute regarding employment status, and respondent has not made a determination concerning employment status. Consequently, we do not have jurisdiction under *section 7436(a)*.

Petitioners argue that we nevertheless should assert jurisdiction over Mr. Salazar's collection dispute involving his employment tax liabilities because we did so in another case involving an offer-in-compromise for employment tax liabilities. In *Collier v. Commissioner, T. C. Memo. 2004-171*, the taxpayer wanted to submit an offer-in-compromise for unpaid income tax liabilities for several years in issue. However, the Commissioner concluded that the taxpayer was precluded from pursuing an offer because the taxpayer was noncompliant in filing his employment tax returns and in paying his employment tax liabilities as required by the Internal Revenue Manual. Id. Consistent with other cases addressing similar facts, we held that the Commissioner's decision not to process an offer-in-compromise because the taxpayer had not filed all required tax returns is not an abuse of

discretion. [*13] *Id.*; see also *Rodriguez v. Commissioner, T. C. Menlo. 2003-153*; *Londono v. Commissioner, T. C. Memo. 2003-99.*

Petitioners' reliance on *Collier* is misplaced because the facts are distinguishable. The taxpayer in Collier wanted to compromise only his unpaid income tax liabilities; he was not trying to compromise any employment tax liabilities. *Collier v. Commissioner, supra.* The Appeals officer in Collier refused to consider any compromise of the taxpayer's income tax liabilities because the taxpayer had not filed all of his returns as required by the Internal Revenue Manual.[8] We upheld the Appeals officer's determination. *Id.* In this case, petitioners' offer-in-compromise included all of petitioners' unpaid Federal tax liabilities, including Mr. Salazar's employment tax liabilities, and there is no suggestion in the record that petitioners had failed to file required returns when the Appeals officer considered the offer and rejected it on its merits.

[* 14] Although petitioners are unable to cite a statute that confers jurisdiction on this Court over Mr. Salazar's employment tax liabilities, they nevertheless argue that we should hear their case as a matter of convenience and equity because, otherwise, they must litigate their case in two different forums. Although petitioners raise a

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[8] In fact, the taxpayer in Collier v. Commissioner, T.C. Memo. 2004-171, did not actually submit an offer-in-compromise.

legitimate concern,[9] we do not acquire jurisdiction based on convenience to the parties or judicial economy. See *Trost v. Commissioner, 95 T.C. 560, 565 (1990)*; *Judge v. Commissioner, 88 T.C. 1175, 1180-1181 (1987)*. Accordingly, we shall grant respondent's motion to dismiss for lack of jurisdiction and to strike with respect to Mr. Salazar's employment tax liabilities for quarters ended December 31, 1998, through June 30, 2001.

[*15] To reflect the foregoing,

An appropriate order will be issued.

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[9] Ironically, if petitioners had submitted an offer-in-compromise covering only their income tax liabilities, the offer very likely would have been summarily rejected under the Service's existing procedures because an offer-in-compromise must include all unpaid Federal tax liabilities for it to be processed. See *Rev. Proc. 2003-71, 2003-2 C.B. 517*; 1 Administration, Internal Revenue Manual (CCH), sec. 5.8.1.7, at 16,256 (Sept. 1, 2005). Ideally, a taxpayer's exercise of his rights under *sec. 6330* should not subject him to multiple judicial proceedings in order to obtain a complete review of the Service's decision to reject the taxpayer's offer-in-compromise. However, this is what must happen under current law in cases like the one before us.

Internal Revenue Service
Appeals Office
403 New Karner Road
Albany, NY 12205

Date: JAN 4 2005

CLAUDE E. & DANA L SALAZAR
PO BOX 342
NASSAU NY 12123

Department of the Treasury
Person to Contact:
Bruce E Conte
Employee ID Number: 14-015 3 6
Tel: 518-464-1622 Ext. 16
Fax: 518-464-1636
Contact Hours: 8:00AM- 3:00PM
Refer Reply to:
AP:FE:A2:ALB:BEC
SSN/EIN Number:
[REDACTED]
Tax Type/Form Number:
1040
In Re:
Collection Due Process Hearing
(Tax Court)
Tax Period(s) Ended:
12/1997 12/1998 12/1999

Certified Mail

NOTICE OF DETERMINATION CONCERNING COLLECTION ACTION(S) UNDER SECTION 6320 and/or 6330

Dear Mr. & Mrs. Salazar:

We have reviewed the taken or proposed collection action for the period(s) shown above. This letter is your Notice of Determination, as required by law. A summary of our determination is stated below. The attached statement shows, in detail, the matters we considered at your Appeals hearing and our conclusions about them.

If you want to dispute this determination in court, you must file a petition with the United States Tax Court for a redetermination within 30 days from the date of this letter.

To get a petition form and the rules for filing a petition, write to: Clerk, United States Tax Court, 400 Second Street. NW. Washington, D.C. 20217, or access the Tax Court website at www.ustaxcourt.gov.

The Tax Court has a simplified procedure for an appeal under section 6330(d)(1)(A) of a determination in which the unpaid tax does not exceed $50,000. You also can get information about this procedure by writing to the Tax Court, or accessing the Tax Court website at www.ustaxcourt.gov.

The time limit for filing your petition is fixed by law. The courts cannot consider your case if you file late. If the court determines that you filed your petition with the wrong court, you will have 30 days after such determination to file with, the correct court.

If you do not petition the court within the time frame provided by law, your case will be returned to the originating IRS office for action consistent with the determination summarized below and described on the attached page(s).

If you have any questions, please contact the person whose name and telephone number are shown above.

Summary of Determination

It is Appeals ' determination that you have not challenged the correctness of the liability or the appropriateness of the proposed action and that the alternative that you have proposed, in the form of an Offer in Compromise, is in an insufficient amount to make it viable. Therefore Compliance may resume enforced collection of the balance due.

Sincerely,

s/ _____
Carl Garkowski
Team Manager

cc: Jeremy H Speich Esq.

ACM/DETERMINATION LETTER

Taxpayer: **SALAZAR, CLAUDE E. & DANA L.**
SSN: [REDACTED]

Type of tax	Tax period	Date of CDP Notice	Date F12153 Mailed
1040	Dec 31, 97	Dec 6. 03	Dec 16, 03
1040	Dec 31, 98	Dec 6. 03	Dec 16, 03
1040	Dec 31, 99	Dec 6. 03	Dec 16, 03

Due Process - Levy

SUMMARY AND RECOMMENDATION

You have requested a Collection Due Process Hearing with regard to the issuance of a Final Notice - Notice of Intent to Levy and Notice of Your Right to a Hearing (Final Notice) pertaining to the above tax periods. The question in this matter is whether you have made a valid challenge to the correctness of the liability or the appropriateness of the proposed action or have offered a viable alternative to the proposed action.

It is Appeals' determination that you have not challenged the correctness of the liability or the appropriateness of the proposed action but you have requested an alternative in the form of an Offer in Compromise (OIC). Unfortunately the amount offered is not sufficient to make it a viable alternative and Appeals' is sustaining the

Compliance decision to begin enforced collection of the balance due.

BRIEF BACKGROUND

In December 2003 you were issued a "Final Notice" for the above periods. These periods had been a part of a personal bankruptcy proceeding that was discharged in 2002 but these periods were not dischargeable. You submitted your request for a Collection Due Process Hearing shortly after receipt of the "Final Notice" apparently requesting assistance in "finalizing" the bankruptcy. As a further step in the direction of finalizing this entire liability, you filed an OIC in the amount of $9.024.25 to satisfy this and a business liability that still exists.

DISCUSSION AND ANALYSIS

1 Verification of legal and procedural requirements:

IRC 6331 (d) requires that the IRS notify a taxpayer at least 30 days before the date of the levy. IRC 6330(a) requires that a taxpayer be notified that he has an opportunity for a hearing prior to a levy. The record shows that a Notice Letter 1058/LT11 was mailed to you on Dec 6, 03, satisfying the requirements of Sections 6330(a) and 6331 (d). You responded on Dec 16, 04 by sending in F12153, Request for Collection Due Process Hearing, and a timely request. Many discussions and much correspondence was sent between

Appeals and your Power of Attorney (POA) and in the end the POA advised that there was no need for a conference, that all information had been given verbally or via correspondence.

A review of the transcript for this period does not indicate that an Installment Agreement or an Offer in Compromise is in effect.

This Settlement Officer has had no prior involvement with the periods in this matter.

I find that all legal and procedural requirements for the proposed levy have been satisfied.

2. Issues raised by the taxpayer:

The only issue raised that is within the purview of Appeals is that of an alternative to the issuance of a notice of levy. In that regard you offered an Offer in Compromise in the amount of $9,024.25. You supplied the financial information required for Appeals to consider your offer. However, the issue of the undistributed assets being held by the Bankruptcy Trustee rose as an important issue. The trustee is holding in excess of $25,000 to be distributed. The only known distributees are the IRS and the Trustee for his fee. If an OIC was accepted, the bankruptcy periods would then be closed and the IRS would not receive the funds it is currently entitled to as part of the distribution. Advice from Counsel is to increase the amount acceptable as part of the OIC by the amount the Service could expect to receive from the

bankruptcy, which is estimated to be approximately $20,000. Appeals made this proposal to you and you adamantly declined.

You have sent correspondence indicating that a distribution "could be expected, perhaps by the end of the year". Unfortunately this is not a definite solution, it is a maybe. While the fault is not in your hands, it is not in the best interests of the Service to give away $20,000. While an OIC is not an immediate solution, you are free to submit another Offer in Compromise once the distribution has been made.

No other issues were raised.

3. Balancing of need for efficient collection with taxpayer concern that the collection action be no more intrusive than necessary:

It is Appeals' determination that the use of a levy would properly balance the need for efficient collection of the tax with your concerns over the intrusiveness of the proposed collection action because you have not offered a valid challenge to the appropriateness of this action, have not offered a valid challenge to the correctness of the liability and have not proposed a viable alternative to this action. The use of the levy would be intrusive but there appears to be no other resolution to this matter at this time.

Internal Revenue Service
Appeals Office
403 New Karner Road
Albany, NY 12205

Date: ,JAN 4 2005

CLAUDE E. SALAZAR
PO BOX 342
NASSAU NY 12123-0342

Department of the Treasury
Person to Contact:
Bruce E Conte
Employee ID Number: 14-015 3 6
Tel: 518-464-1622 Ext. 16
Fax: 518-464-1636
Contact Hours: 8:00AM- 3:00PM
Refer Reply to:
AP:FE:A2:ALB:BEC
In Re:
Collection Due Process Hearing
(Tax Court)
Tax Period(s) Ended:
12/1998 03/1999 06/1999
09/1999 12/1999 03/2000
06/2000 09/2000 12/2000
03/2001 06/2001

Dear Mr. & Mrs. Salazar:

This refers to your offer of $9,024.25, submitted June 9, 2004 to compromise your liability for the above tax periods.

We are sorry, but your offer is rejected because the tax is held to be legally due and an amount larger than the offer appears to be collectible. We do not have authority to accept an offer in these circumstances.

We must therefore ask you to pay your account in full as soon as possible. If you have any questions, please contact the person whose name and telephone number are shown above.

Sincerely,

s/ _____
Carl Garkowski
Team Manager

cc: Jeremy H Speich

OFFER IN COMPROMISE:

Taxpayer(s): **SALAZAR, CLAUDE & DANA L. EIN: 88-0334504**

Period(s): Dec 31, 98, Mar 31, 99, Jun 30, 99, Sep 30, 99, Dec 31, 99, Mar 31, 00, Jun 30, 00, Sep 30, 00, Dec 31, 00, Mar 31, 01 & Jun 30, 01

SUMMARY AND RECOMMENDATION

Should the taxpayer's Offer in Compromise (OIC) be accepted in the amount of $9,024.25 to satisfy the above liabilities as well as related IMF liabilities?

It is Appeals' decision that the OIC should not be accepted because it has been determined that the taxpayer has the ability to pay a larger amount than offered over the life of the statute and that the funds remaining undistributed by the Bankruptcy Trustee must be considered as a part of that calculation.

BRIEF BACKGROUND

The taxpayer's have submitted an OIC for the above periods on a doubt as to collectibility basis to COOC, Brookhaven. This OIC was submitted coincidentally with a Collection Due Process request to Appeals. The OIC was not perfected by COIC and when received by Appeals it was determined to wait on perfecting the F656 until it

was determined if the offer was acceptable. The Form 656 would have to be redone removing the IMF and the IMF periods would have been a separate F656 because it is in the name of the taxpayer husband and wife. An initial determination was made that a problem existed because of a discharged bankruptcy case and because there were undistributed assets remaining in the bankruptcy.

DISCUSSION AND ANALYSIS

Section 7122 of the Internal Revenue Code authorized the Secretary to compromise any civil or criminal liability. Reg. 301.7122-1T provides 3 bases for accepting an offer: doubt as to collectibility, doubt as to liability and effective tax administration. The taxpayer submitted an offer based on doubt as to collectibility.

As is noted above the taxpayer has submitted an OIC in this matter in the amount of $9,024.25 to satisfy the above liabilities as well as the related IMF liabilities. The fact that there were undistributed funds in a BMF bankruptcy was noted early on and the taxpayer was made aware of the problem. Appeals continued to gather relevant information concerning the taxpayer's ability to pay hoping that the bankruptcy distribution would be made or that a definitive response would be received from our Counsel on this problem. The problem with the undistributed funds is that if the OIC is accepted, the BMF liabilities would no longer exist and any funds in the remaining as a

result of the bankruptcy would go to other creditors or to the taxpayer. The Service would have no legal right to those funds.

In order to insure that the Service received the maximum amount from both the bankruptcy distribution and the Offer, prior to the final distribution, the amount of the offer must be increased by the amount we believe the Service would receive from the distribution. Since we are aware that there is about $25,000 remaining undistributed and the only known recipients would be the Service and the Trustee, the taxpayer was advised that any offer amount deemed appropriate by the Service based on their ability to pay, would have to be increased by $20,000.00 (the amount Appeals has determined would be received as a distribution).

The taxpayer does not feel that Appeals is acting fairly in insisting on the additional amount, stating that it would be impossible for the taxpayers to pay over the $20,000.00 that is estimated being held by the Trustee not to mention the amount determined to be acceptable aside from the distribution.

The taxpayer's latest correspondence states that in a conversation with the Asst. U.S. Trustee for Bankruptcy Court in Reno, Nev. he indicated that there was $25,253.63 pending distribution and that a distribution could be expected perhaps by the end of the year. This is by no means a firm commitment by the Trustee to make distribution by then. The phrase "could be expected perhaps by

the end of the year" indicates no definite time line for distribution. Considering that the taxpayer has been discharged for more than three years, the Trustee does not appear to be concerned with a rapid resolution to this matter.

MY EVALUATION

Based upon informal advice from Counsel and the taxpayer's response, it is Appeals' decision to reject the Offer of $9,024.25 as insufficient due to the fact that a larger amount appears to be collectible. Once the final distribution has been made the taxpayer is free to submit another Offer in Compromise on this matter.

ACM/DETERMINATION LETTER
Taxpayer: **SALAZAR, CLAUDE E. & DANA L.**
SSN: [REDACTED]

Type of tax	Tax Period	Date of CDP Notice	Date F12153 Mailed
1040	Dec 31, 97	Dec 6, 03	Dec 16, 03
1040	Dec 31, 98	Dec 6, 03	Dec 16, 03
1040	Dec 31, 99	Dec 6, 03	Dec 16, 03

Due Process - Levy

SUMMARY AND RECOMMENDATION

You have requested a Collection Due Process Hearing with regard to the issuance the above Final Notice – Notice of Intent to Levy and Notice of Your Right to a Hearing (Final Notice) pertaining to the above tax periods. The question in this matter is whether you have made a valid challenge to the correctness of the liability or the appropriateness of the proposed action or have offered a viable alternative to the proposed action.

It is Appeals' determination that you have not challenged the correctness of the liability or the appropriateness of the proposed action but you have requested an alternative in the form of an Offer in Compromise (OIC). Unfortunately the amount offered is not sufficient to make it a viable alternative and Appeals' is sustaining the Compliance decision to begin enforced collection of the balance due.

BRIEF BACKGROUND

In December 2003 you were issued a "Final Notice" for the above periods. These periods had been a part of a personal bankruptcy proceeding that was discharged in 2002 but these periods were not dischargeable. You submitted your request for a Collection Due Process Hearing shortly after receipt of the "Final Notice" apparently requesting assistance in "finalizing" the bankruptcy. As a further step in the direction of finalizing this entire liability, you filed an OIC in the amount of $9,024.25 to satisfy this and a business liability that still exists.

DISCUSSION AND ANALYSIS

1. Verification of legal and procedural requirements:

IRC 6331(d) requires that the IRS notify a taxpayer at least 30 days before the date of the levy. IRC 6330(a) requires that a taxpayer be notified that he has an opportunity for a hearing prior to a levy. The record shows that a Notice Letter 1058/LT11 was mailed to you on Dec 6, 03, satisfying the requirements of Sections 6330(a) and 6331 (d). You responded on Dec 16, 04 by sending in F12153, Request for Collection Due Process Hearing, and a timely request. Many discussions and much correspondence was sent between Appeals and your Power of Attorney (POA) and in the end the POA advised that there was no need for a conference,

that all information had been given verbally or via correspondence.

A review of the transcript for this period does not indicate that an Installment Agreement or an Offer in Compromise is in effect.

This Settlement Officer has had no prior involvement with the periods in this matter.

I find that all legal and procedural requirements for the proposed levy have been satisfied.

2. Issues raised by the taxpayer:

The only issue raised that is within the purview of Appeals is that of an alternative to the issuance of a notice of levy. In that regard you offered an Offer in Compromise in the amount of $9,024.25. You supplied the financial information required for Appeals to consider your offer. However, the issue of the undistributed assets being held by the Bankruptcy Trustee rose as an important issue. The trustee is holding in excess of $25,000 to be distributed. The only known distributees are the IRS and the Trustee for his fee. If an OIC was accepted, the bankruptcy periods would then be closed and the IRS would not receive the funds it is currently entitled to as part of the distribution. Advice from Counsel is to increase the amount acceptable as part of the OIC by the amount the Service could expect to receive from the bankruptcy; which is estimated to be

approximately $20,000. Appeals made this proposal to you and you adamantly declined.

You have sent correspondence indicating that a distribution "could be expected, perhaps by the end of the year". Unfortunately this is not a definite solution, it is a maybe. While the fault is not in your hands, it is not in the best interests of the Service to give away $20,000. While an OIC is not an immediate solution, you are free to submit another Offer in Compromise once the distribution has been made.

No other issues were raised.

3. Balancing of need for efficient collection with taxpayer concern that the collection action be no more intrusive than necessary:

It is Appeals' determination that the use of a levy would properly balance the need for efficient collection of the tax with your concerns over the intrusiveness of the proposed collection action because you have not offered a valid challenge to the appropriateness of this action, have not offered a valid challenge to the correctness of the liability and have not proposed a viable alternative to this action. The use of the levy would be intrusive but there appears to be no other resolution to this matter at this time.

Internal Revenue Service
Appeals Office
403 New Karner Road
Albany, NY 12205

Date: OCT 18, 2006

Claude E. Salazar
PO Box 342
Nassau, NY 12123

Department of the Treasury

Person to Contact:
Thomas A Conley
Employee ID Number: 14-00306
Tel: (518) 464-1622 Ext. 18
Fax: (518) 464-1636
Refer Reply to:
AP:FE:A2:ALB:TAC
SSN/EIN Number:
[REDACTED]
Tax Type/Form Number:
Withholding Tax/Form 941
In Re:
Collection Due Process Hearing (Tax Court)
Tax Period(s) Ended:
941-06/1999 09/1999 12/1999
03/2000 06/2000 09/2000
12/2000 03/2001 06/2001

Certified Mail

NOTICE OF DETERMINATION CONCERNING COLLECTION ACTION(S) UNDER SECTION 6320 and/or 6330

Dear Mr. Claude Salazar:

We have reviewed the taken or proposed collection action for the period(s) shown above. This letter is your Notice of Determination, as required by law. A summary of our determination is stated below. The attached statement shows, in detail, the matters we considered at your Appeals hearing and our conclusions about them.

If you want to dispute this determination in court, you must file a petition with the United States Tax Court for a re-determination within 30 days from the date of this letter.

To get a petition form and the rules for filing a petition, write to: Clerk, United States Tax Court, 400 Second Street, NW, Washington, D.C. 20217, or access the Tax Court website at www.ustaxcourt.gov.

The Tax Court has a simplified procedure for an appeal under section 6330(d)(1)(A) of a determination in which the unpaid tax does not exceed $50,000. You also can get information about this procedure by writing to the Tax Court, or accessing the Tax Court website at www.ustaxcourt.gov.

The time limit for filing your petition is fixed by law. The courts cannot consider your case if you file late. If the court determines that you filed your petition with the wrong court, you will have 30 days after such determination to file with the correct court.

If you do not petition the court within the time frame provided by law, your case will be returned to the originating IRS office for action consistent with the determination summarized below and described on the attached page(s).

If you have any questions, please contact the person whose name and telephone number are shown above.

Summary of Determination

It is Appeals determination that the Compliance Division may proceed with the proposed levy action because you have not supported your proposal of an alternative to collection.

Sincerely,

s/_____

John O'Dea	John O'Dea
Team Manager	Appeals Team Manager

Cc: Jeremy H. Speich

Attachment to 3193 Letter, Notice of Determination
Collection Due Process DPLV
Taxpayer: Claude E. Salazar

Type of Tax	Tax period	Date of CDP Notice	Date F12153 was mailed
941	06/30/1999	02/22/2006	03/15/2006
941	09/30/1999	02/22/2006	03/15/2006
941	12/31/1999	02/22/2006	03/15/2006
941	03/31/2000	02/22/2006	03/15/2006
941	06/30/2000	02/22/2006	03/15/2006
941	09/30/2000	02/22/2006	03/15/2006
941	12/31/2000	02/22/2006	03/15/2006
941	03/31/2001	02/22/2006	03/15/2006
941	06/30/2001	02/22/2006	03/15/2006

Issue

You requested a collection due process hearing in response to the notice of intent to levy in connection with the liability for these tax periods. The question here is whether you have a valid issue in connection with the proposed levy action.

It is Appeals determination that the Compliance Division may proceed with the proposed levy action because you have not supported your proposal of an alternative to collection.

Brief History

The liability for each of the tax years listed above is the result of your failure to deposit the withheld taxes for your employees.

As each return was filed reflecting a balance due, tax, penalty and interest were assessed. Notice of the assessment along with demand for payment was issued to you. You did not pay the balance shown due on the notice.

A final notice, notice of intent to levy, and notice of your right to a Collection Due Process (CDP) hearing was issued. You responded with a timely request for a hearing.

A conference held in the Albany Appeals' Office with you and your Power of Attorney (POA) Jeremy Speich, on June 15, 2006.

Discussion and analysis

RRA 98 established the taxpayer's right to a due process hearing when a due process notice has been sent to the taxpayer under either IRC 6320 or 6330 and the taxpayer makes a timely request for a hearing. The law provides that the taxpayer may raise challenges to the appropriateness of the collection action and may offer collection alternatives. In some circumstances the taxpayer may challenge the underlying liability when the taxpayer did not otherwise have an opportunity to challenge the liability before Appeals. Where a jointly filed income tax return is represented on the

CDP notice, the law provides that the taxpayer may raise appropriate spousal issues.

Appeals is required by law to:

- Verify the requirements of law and procedure have been met
- Address all issues raised by the taxpayer
- Address whether the collection action balances the need for efficient collection of the tax with the taxpayer's legitimate concerns that the collection action be no more intrusive than necessary

Have the requirements of law and administrative procedures been met?

IRC 6201 and 6303 provide the authority for the IRS to make an assessment and require the IRS to issue notice and demand to you at the last known address for the unpaid amount within sixty days of assessment. IRC 6321 establishes a statutory lien for the amount of the unpaid liability in favor of the government if you do not pay the liability within ten days after notice and demand. A statutory lien is a prerequisite for levy action or for filing of a notice of Federal tax lien. Computer records confirm that assessments were made and that notice and demand was timely issued to you. You did not pay the liability within ten days after notice and demand. IRC 6330 and IRC 6331 require that you be sent a final notice and notice of your right to a collection due process hearing not less than thirty days prior to levy. The notice was sent to you by certified mail on February 22, 2006. You responded

with a timely request for a hearing. A hearing was held on June 15, 2006.

Your hearing request was assigned to a Settlement Officer having no prior involvement with respect to the tax liabilities.

All legal and administrative requirements have been met.

What are the issues you raised?

You submitted an Offer in Compromise as your proposal of an alternative to collection. The offer was filed to compromise the liabilities for the above employment tax liabilities as well as personal income tax liabilities for the periods ended December 31, 1998 and December 31, 1999. On the Form 656, offer in compromise (OIC), you indicated your reason for submitting the offer was due to a Doubt as to Collectibility. The total assessed balance due is $44,951.88 and the amount of your offer was $19,547.13.

A Form 433A, Collection Information Statement, was provided with the offer. The statement listed the income and expenses for the household. Based on the information provided, the expenses claimed were adjusted for allowable expenses and too conform to national and local standards. Based on the income information it was determined that you earn 51 % on the total household income. Household expenses were therefore adjusted

accordingly. A monthly Income/Expense table was prepared from the information provided.

MONTHLY INCOME/EXPENSE TABLE

Total Income		Necessary Living Expenses			
Source	Gross		Claimed	Total Home Allowed	TP % 51%
Wages (Taxpayer)	$ 4,341	National Standard Expenses	$ 1,659	$ 1,368	698
Wages (Spouse)	5,764	Housing and Utilities	419	419	214
Social Security (TP)	1,667	Transportation	1,061	1,196	610
		Health Care	184	184	94
		Taxes	1,230	1,230	627
		Life Insurance	19	19	10
		Child/Dependent Care	163	163	83
		Other Student Loan/Pro Fees (Spouse's) Profession	780 800	780 800	408

		al Fees/Atty			
Total Income	$11,772	Total Expenses	$ 6,315	$ 6,159	$ 2,744
Income Attributable To Responsible Person	$ 6,008				

Net Difference Income to Household Expenses: $11,772 - 6,159 = $5,613
Net Difference Responsible Person: $6,008 - 2,744 = $$3,264

The amount that could be paid to the Internal Revenue Service from future income was calculated to be $156,672 ($3,264 multiplied by 48 months).

A review of your financial information revealed additional assets that are also taken into consideration in the determination of an acceptable offer in compromise. The equity in assets is shown on the Asset/Equity Table.

ASSET/EQUITY TABLE

ASSET	Fair Market Value	Quick Sale Value	Encumbrances	Net Realizable Equity
Cash/ Bank	$	NA	50%-	$ 1,277

Accounts	2,554		$1,277	
Vehicles	30,000	$24,000	$ 34,497	-0-
Pension	4, 000	3,400	-0-	3,400

Total Net Realizable Equity from Asset/Equity Table	$ 4,677
Future Income Value	$ 156,672
Reasonable Collection Potential	$ 161,349

The calculation of the reasonable collection potential reflects the ability of the government to collect an amount greater than the offer. Under the circumstances, Appeals would be unable to recommend acceptance of the offer in compromise.

No other issues were raised.

Has the need for efficient collection of the tax been balanced with your legitimate concerns over the intrusiveness of the proposed collection action?

Yes. It is Appeals determination that the Compliance Division may proceed with the proposed levy action because you have not supported you proposal of an alternative to collection. The use of levy would properly balance the need for efficient collection of the tax with your

concerns over the intrusiveness of the proposed collection action.

UNITED STATES COURT OF APPEALS
FOR THE SECOND CIRCUIT

At a stated term of the United States Court of Appeals for the Second Circuit, held at the Daniel Patrick Moynihan United States Courthouse, 500 Pearl Street, in the city of New York, on the 26th day of October, two thousand and nine.

United States Court of Appeals
Filed
October 26, 2009
Catherine O'Hagan Wolfe, Clerk
Second Circuit

CLAUDE E. SALAZAR, DANA L. SALAZAR,

Petitioner-Appellants,

v.

COMMISSIONER OF INTERNAL REVENUE,

Respondent-Appellee.

DC/ 23547-06L
No. 08-2670-ag(L)
No. 08-3842-ag(CON)

Petitioners Claude Salazar and Dana Salazar having filed a petition for panel rehearing, or, in the alternative, for rehearing *en banc*, and the panel that determined the appeal having considered the request for panel rehearing, and the active members of the Court having considered the request for rehearing *en banc*,

IT IS HEREBY ORDERED that the petition is denied.

FOR THE COURT:
Catherine O'Hagan Wolfe, Clerk

By: s/_____
Frank Perez, Deputy Clerk